89-532

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

PEAT MARWICK MAIN & CO.,

Petitioner,

—v.—

W. DAVID HOLLOWAY, *et al.*,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTION PRESENTED

Are uninsured passbook savings accounts and thrift certificates issued by state chartered institutions subject to state and Federal Reserve Board regulation "securities" as that term is used in the Securities Act of 1933 and the Securities Exchange Act of 1934 (the "Securities Acts")?

In considering that question:

a. May a court wholly exclude consideration of state regulation with respect to passbook savings accounts and thrift certificates issued by state chartered institutions in determining whether such instruments are "securities" under the Securities Acts as interpreted by this Court in *Marine Bank* v. *Weaver*, 455 U.S. 551 (1982)?

b. May passbook savings accounts and certificates of deposit (or the equivalent "thrift certificates"), as terms known to and used by the Congress which enacted the Securities Acts, be deemed securities under those Acts, notwithstanding Congress' determination not to include these terms within the Acts' definitions?

c. May the passbook savings accounts and thrift certificates of state chartered institutions be deemed securities under the Securities Acts notwithstanding the fact that they do not satisfy the general requirements for inclusion established by this Court in *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946)?

PARTIES BELOW

Petitioner Peat Marwick Main & Co. ("Peat Marwick"), then known as Peat, Marwick, Mitchell & Co., was named as a defendant below along with Sunbelt Bank & Trust Company, formerly Republic Bank & Trust Co., a State Bank Association; Wesley R. McKinney, individually; Phillips Breckinridge, Administrator of the Estate of Glenn F. Prichard, Deceased; RBI of Oklahoma, Inc., a Delaware corporation; R.R. Bastian, III; Hal W. Oswalt; Harold J. Born; William J. Doyle, Jr.; Horace H. Porter, M.D.; William W. Ramsey; Edward B. Wilcox; Altus E. Wilder, III; G. Larry Young; Orville J. Bertalot; Ted C. Bodley; Keith E. McNeal; Edward L. Taylor; Charles G. Wray; Ansil Ludwick, Jr.; Paul W. Anderson, Jr.; G. Richard Degen; Brown J. Akin, Jr.; Robert C. Bates; Richard G. Bell; Bob C. Lamirand; Douglas W. Dixon; Rodney Miller; Dan W. Allred; Timothy J. Sullivan; Dwight A. Pilgram; Roger H. Laubach; James D. Essig; Martha J. Cravens; Wilma F. Wood; Charles Schusterman; Richard Williford; and Republic Bancorporation, Inc., also known as Sunbelt Bancorporation, Inc., an Oklahoma corporation.

Plaintiffs below, as representatives of a purported class of plaintiffs, were W. David Holloway, M.D.; Lisa Holloway; Charles Woodard; Linda Woodard; Maxine Black, individually and as Trustee for James T. Black and Shellie Black; Porter-Strait Instrument Co., Inc., an Oklahoma corporation; Jeremy K. Bush; Shirley Bush; United Resources Building Company, Inc., an Oklahoma corporation; Hugh Hollowell; Marshall H. Udden; Mary F. Udden; Howard R. Cadwell; Doris G. Cadwell; William L. Akers; Norita L. Akers; Cal Acree; Betty K. Acree; Robert John Walpole; Bobbee C. Ray, individually and as Trustee for James F. Haning, II and Angela Jean Haning Revocable Trust and Victoria Nininger; Joy A. Donovan, as Trustee for James M. Donovan and John A. Donovan; R.H. Arnold; Marvelle McDaniel; Martha Hester Arnold; Claudette Howe; Fred E. Miller; Vera Miller; Beverly Joyce Miller; Ann McCloud; Joyce McClure; Charlotte A. Broad, individually

and as Trustee for Russell M. Gawf and Megan D. Gawf; John E. Broad; John W. Broad and Dewayne Broad.

Peat Marwick seeks review in this Petition. No other petition has been filed as of this date.

Pursuant to Rule 28.1 of the Rules of this Court, Peat Marwick Main & Co. informs the Court that it is a partnership with no ownership interest held by members of the public.

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W. DAVID HOLLOWAY, *et al.*,

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Petitioner Peat Marwick Main & Co. ("Peat Marwick") respectfully prays that a writ of *certiorari* issue to review the decision and judgment of the United States Court of Appeals for the Tenth Circuit, entered in the above-entitled proceeding on July 11, 1989.

OPINIONS BELOW

The opinion of the Court of Appeals for the Tenth Circuit is reported at 879 F.2d 772 and is set forth in the Appendix to this Petition at 1a.

The memorandum decisions of the District Court for the Northern District of Oklahoma (Eubanks, J.) have not been reported. They are set forth in the Appendix at 31a, 34a, 36a and 42a.

JURISDICTION

Federal jurisdiction was invoked by plaintiffs below under 28 U.S.C. § 1331 (1982), 15 U.S.C. §§ 77a *et seq.* (1982 & Supp. V 1987), as amended (Securities Act of 1933), 15 U.S.C. §§ 78a *et seq.* (1982 & Supp. V 1987), as amended (Securities Exchange Act of 1934) and 12 U.S.C. §§ 1 *et seq.* (1982 & Supp. V 1987), as amended (federal banking laws). On March 3, 1987, the U.S. District Court for the Northern District of Oklahoma granted in part and denied in part defendants' motion for summary judgment, entered final judgment in part under Rule 54(b), Fed. R. Civ. P., and certified for review a controlling issue of law under 28 U.S.C. § 1292(b) (Supp. V 1987). *See* Appendix at 31a.

On the appeals of both plaintiffs and defendants, the Tenth Circuit on July 11, 1989 entered an order that affirmed the Northern District's partial denial of defendants' motion for summary judgment, reversed the partial grant of the motion as to defendants and directed entry of partial summary judgment to plaintiffs, and remanded as to a third portion of the Northern District's judgment and order. *See* Appendix at 1a.

The jurisdiction of this Court to review the decision of the Tenth Circuit is invoked under 28 U.S.C. § 1254(1) (1982), as amended; the Petition is being timely filed within 90 days of the Tenth Circuit's decision.

STATUTES INVOLVED

Securities Act of 1933 § 2(1), 15 U.S.C. § 77b(1) (1982):

> "When used in this subchapter, unless the context otherwise requires—
>
> "(1) The term 'security' means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other

mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a 'security', or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing."

Securities Exchange Act of 1934 § 3(a)(10), 15 U.S.C. § 78c(a)(10) (1982):

"When used in this chapter, unless the context otherwise requires—

* * *

"(10) The term 'security' means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a 'security'; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited."

STATEMENT OF THE CASE

This petition arises from the determination by the United States Court of Appeals for the Tenth Circuit that certain passbook savings accounts and thrift certificates of financial institutions chartered and regulated by the State of Oklahoma and regulated as well by the Federal Reserve Board are "securities" for the purposes of the federal securities laws. The Tenth Circuit's rulings, premised on reasoning expressly acknowledged to be in conflict with that of other Circuits in two distinct respects, provided a basis for federal subject matter jurisdiction as well as a federal cause of action in these civil suits brought by the owners of the accounts and certificates for damages stemming from the business failure of the institutions in question.

The Institutions and Instruments at Issue

The litigation underlying this petition has, as its genesis, three types of instruments—"passbook savings certificates", "thrift certificates" and a single promissory note (not at issue on this petition). As the district court in this case noted as to the passbook and thrift certificates, "[t]hese instruments were very similar to certificates of deposit except they were not issued by a bank. . . ." (App. 35a) The instruments were issued by three institutions: Republic Bankcorporation, Inc. ("Republic Holding"), Republic Financial Corporation ("Republic Finance") and Republic Trust and Savings ("Republic Trust"). All of these institutions, along with several others, were part of a single financial group. Until June of 1984, Republic Holding was the bank holding company parent of Republic Trust and Republic Finance as well as the Republic Bank and Trust Company (a state-chartered, FDIC-insured bank).[1]

Republic Trust and Republic Finance both accepted deposits of currency in return for which they provided either passbook savings account certificates or one of several kinds of thrift cer-

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1 According to the Federal Reserve Board, there were 5,904 such holding company groups as of December 31, 1987, operating 9,322 banks with 50,719 branches and total deposits of $1,786,618,000,000. Federal Reserve Board, *Annual Statistical Digest 1987* (October 1988).

tificates. Each certificate for a passbook account listed a specific registered owner and address on its face. The certificate acknowledged the indebtedness and set forth an agreement to pay interest at a rate fixed pursuant to uniform rules regulating the account. An account was effectively non-negotiable and provided the holder no ownership or control rights with respect to the institution. The passbook savings certificates provided that, subject to stated limitations relating to total cash flow and permitting the imposition of a 30-day notice requirement, "[w]ithdrawals from and deposits to this account may be made at any time in person, by mail or by electronic funds transfer, where available."[2]

The thrift certificates had fixed maturities varying from three months to three years (except for the "market rate thrift certificates", which were essentially demand instruments), paid interest at a rate stated or described in the certificate and resembled bank certificates of deposit, both as a matter of form and in that they were non-brokered and effectively non-negotiable. All of this information, as well as information about the relevant institution, was set forth on the face of the certificates or in offering circulars (Republic Trust) or in prospectuses (Republic Finance). Depositors received no ownership interest in the institutions and no right to share in the profits or governance of the institutions.[3]

On September 24, 1984, Republic Trust and Republic Finance filed separate, simultaneous voluntary petitions for relief under 11 U.S.C. Chapter 11 in the United States Bankruptcy Court for the Northern District of Oklahoma.

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2 Examples of a passbook savings certificate and a thrift certificate are included in the Appendix to this petition at 72a (passbook savings certificate) and 76a (thrift certificate). (Record citations in this petition ("R. _____") will take the form used below. The passbook savings certificate is found at R.H. 63; the thrift certificate was appended as Plaintiff's Exhibit 00002 to the Amended Complaint.)

3 Although these characteristics were set forth in the record, the Tenth Circuit's opinion did not focus on them, emphasizing instead that the certificates were offered to the public generally. (App. 13a-15a)

Applicable Regulation

1. *State Regulation*

Republic Trust was chartered as a state-regulated trust company on August 22, 1963 pursuant to the Oklahoma Banking Code.[4] Republic Holding acquired the trust company in 1974. As a trust company subsidiary of a bank holding company, Republic Trust was subject to regulation by the Board of Governors of the Federal Reserve (*see* discussion at 8-10, *infra*) and also to regulation by the Oklahoma State Banking Department throughout the relevant time period (the "State Banking Department").

Under Oklahoma law, a trust company is treated much like a bank. Its charter is issued by the State Banking Department, and its activities are governed by the Oklahoma Banking Code, Okla. Stat. tit. 6. Banks and trust companies have similar powers under the Oklahoma Banking Code,[5] and no distinction is drawn between banks and trust companies with respect to, *inter alia*, registration requirements, stock transfers, or the organization of corporate functions.[6] The Department may require a bank or a trust company to charge off or write down assets, to maintain adequate insurance for the protection of depositors, trust funds and the public, and to levy upon shareholders to cure an impairment of capital.[7] The Department may deny approval of a decrease of capital stock, and may restrict payment of dividends.[8] The Department is empowered to order a bank or a trust company to remove an officer, director or

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4 Trust companies are one category among several which collectively are sometimes referred to as "non-bank banks." Such institutions fulfill many of the savings and lending functions associated with more traditional banks and are state chartered. They have billions of dollars in deposits. *See* n.25, *infra*.

5 Okla. Stat. Ann. tit. 6, § 402 (West 1984). Citations to Oklahoma statutes herein are to versions in force during the relevant time period. Many other states have similar patterns of regulation.

6 *Id.*, § 104; § 218; §§ 701 *et seq.* (West 1984).

7 *Id.*, § 204; § 220 (West 1984).

8 *Id.*, § 405 (West 1984).

employee whose conduct is "likely to seriously weaken the condition of the institution."[9] The Banking Code also requires that banks and trust companies maintain set levels of capital and surplus,[10] submit to periodic inspections,[11] and prepare periodic reports.[12] Trust companies also are subject to restrictions as to investments,[13] advertising,[14] and their powers to receive general deposits and make loans.[15]

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9 *Id.*, § 210 (West 1984).

10 *Id.*, § 303.1 (West 1984).

11 *Id.*, § 209(A) (West 1984). The Oklahoma Deputy Commissioner (now Commissioner) of the Oklahoma State Banking Department testified that such examinations were conducted by FDIC trained examiners in accordance with FDIC standards and classification systems. Deposition testimony of Wayne Osborn at 17-18, 63. (R.O. 17-18, 63)

12 Okla. Stat. Ann. tit. 6, § 209(B) (West 1984). The Commissioner may also call for special reports or make more frequent examinations if deemed necessary.

13 *Id.*, § 1008 (West 1984).

14 Throughout the period in which the instruments in question were issued the relevant regulation provided: "State-chartered banks and trust companies are prohibited from engaging in false, deceptive or misleading advertising, and from publishing or representing by any device whatsoever statements tending to deceive or mislead the public." Rule 18(A), Okla. Banking Dep't Rules and Regulations (1984-85). In 1986, after the failure of the institutions involved in this litigation and many other Oklahoma-based financial institutions, the State Banking Department amended its rules to prohibit any reference in advertising to the Department lest the reader take such reference to imply greater supervision than the Department, in fact, provided.

15 Okla. Stat. Ann. tit. 6, §§ 1001(1), (8) (West 1984). A trust company is limited to receipt of "trust deposits" and for this reason is distinguished from a bank for certain purposes. See *In re Republic Trust & Savings Co.*, 59 Bankr. 606 (Bankr. N.D. Okla. 1986). As the Deputy Commissioner of Banking for the State of Oklahoma recognized, however, "there's very little difference" between "straight deposits" and "trust deposits." Deposition of Wayne Osborn at 133. (R.O. 133) The complaint in this action itself refers to "deposits" and "depositors" (*e.g.* ¶¶ 3.1, 3.2, 4.1) and that term is used in this petition.

Like many state-chartered non-bank banks, savings and loan associations and similar institutions (*see* n.25, *infra*), Republic Trust was not a member of the Federal Deposit Insurance Corporation ("FDIC") or the Federal Savings & Loan Insurance Corporation ("FSLIC").

Republic Finance, an Oklahoma business corporation, was a non-bank finance company,[16] and, as an affiliate of a bank holding company, was regulated by the Federal Reserve. In addition, the Oklahoma Department of Securities exercised regulatory authority over certain aspects of its operations, requiring, for example, that registration statements be filed with respect to Republic Finance's thrift certificates and passbook savings accounts.[17] The Department was empowered to conduct examinations of Republic Finance, and had the power to seek a receiver of its assets if necessary to protect the public interest.[18] Republic Finance was not a member of the FDIC or the FSLIC.

2. *Federal Regulation*

Because Republic Holding was a bank holding company, its entire corporate family was subject to regulation by the Board of Governors of the Federal Reserve, pursuant to the Bank Holding Company Act, 12 U.S.C. §§ 1841 *et seq.* (1982 & Supp. V 1987), as amended. That Act limits the ownership by bank holding companies of non-bank subsidiaries to specified types of entities, including those which, like Republic Trust and Republic Finance, are "so closely related to banking or manag-

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16 In 1985, 1,738 finance companies were in existence nationwide. *Statistical Abstract of the United States*, No. 789 (1988).

17 Okla. Stat. Ann. tit. 71, § 305 (West 1987).

18 *Id.*, § 405 (West 1987); § 406 (West 1987). The Department in fact carried on an extensive, bank-type regulation of Republic Finance beginning in 1979, reviewing its loan portfolio, marketing material, and cash flow, and issuing reports assessing Republic Finance's financial condition, and ordering remedial action.

ing or controlling banks as to be a proper incident thereto." 12 U.S.C. § 1843(c)(8) (Supp. V 1987).[19]

The Bank Holding Company Act requires that each holding company submit reports to the Board at least annually. The Board is required to conduct examinations and inspections of bank holding companies and their subsidiaries, and must prepare reports of its examinations and inspections.[20] The Federal Reserve rigorously inspected Republic Holding and its subsidiaries Republic Trust and Republic Finance throughout the period of its regulatory oversight.[21] The Oklahoma State Banking Department worked *jointly* with the federal officers in inspecting Republic Trust and the Oklahoma Securities Department was in frequent communication with the Federal Reserve with respect to Republic Finance. As a result of these inspections, a variety of changes were put into effect through memoranda of understanding and then cease and desist orders authorized by statute.[22] Federal Reserve regulation of Republic

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19 During the Board's six year period of oversight of Republic Holding, Republic Trust and Republic Finance, it never suggested that the Republic Trust and Republic Finance thrift certificates and passbook savings accounts were securities. If the Federal Reserve had reached such a conclusion, it would presumably have been required to order Republic Holding to stop the issuance of such instruments or to divest Republic Trust and Republic Finance, since an affiliate's issuance of securities as its primary means to finance operations is not considered "related to banking or a proper incident thereto" under the Bank Holding Company Act or the Board's regulations. 12 U.S.C. § 1844(e)(1) (1982) and 12 C.F.R. §§ 225.6(b) and 225.32 (1989).

20 12 U.S.C. § 1844(c) (1982); 12 C.F.R. § 225.5(b) (1989).

21 The Federal Reserve Board conducted extensive annual examinations of the Republic companies in 1980-84. Trustee's Report of Investigation, *In re Republic Finance Corp.* (No. 84-01460) (Bankr. N.D. Okla.) at 13-15.

22 For example, cease and desist orders, issued in October of 1982 and again in 1983, pursuant to the Federal Reserve Board's regulatory powers, directed Republic Finance and Republic Trust as well as Republic Holding to take specific actions as to reserves and loan policies. In 1984 the Federal Reserve began the imposition of daily fines against officers and directors of

(*Footnote continued on next page*)

Trust and Republic Finance ended in June 1984 when Republic Holding divested itself of those companies. A new holding entity, not subject to Federal Reserve regulation and oversight, assumed control of Republic Trust and Republic Finance.

The Proceedings Below

In 1984, plaintiffs-respondents commenced a purported class action in the United States District Court for the Northern District of Oklahoma. Their amended complaint, filed December 10, 1984, alleges federal securities law violations and common law fraud arising out of the sale of these instruments and seeks damages in excess of $70,000,000.[23] Federal subject matter jurisdiction is premised on the securities law claims and, as to various state claims, on pendent jurisdiction dependent on the securities claims. Peat Marwick, the auditor of the financial statements of several of the Republic companies, was named as a defendant.

The defendants moved in the District Court to dismiss the complaint and, in the alternative, for summary judgment on the

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(*Footnote continued from previous page*)

Republic Holding for failure to comply with the terms of the 1983 cease and desist order. Trustee's Report of Investigation, *In re Republic Finance Corp.* (No. 84-01460) (Bankr. N.D. Okla.) at 6.

23 The action was brought on behalf of an alleged class of owners of Republic Trust, Republic Finance and Republic Holding instruments. Class certification was held in abeyance pending the outcome of defendants' motion for summary judgment.

The amended complaint identifies the instruments held by named plaintiffs and, to the extent they are dated, these instruments show a significant majority of the certificates of both Republic Trust and Republic Finance to be dated prior to the June 1984 divestiture. No issuance dates are alleged as to the passbook accounts.

On September 17, 1984, Republic Holding issued a single 91-day promissory note with a face amount of $84,319.73. Plaintiffs allege that this note represents a reissuance of a bank certificate of deposit issued by Republic Holding's bank subsidiary. The court of appeals remanded as to this instrument for lack of evidence. (App. 29a) This is the only Republic Holding instrument considered by the courts below and review of the decision below on this matter is not sought.

grounds that, among other things, plaintiffs had failed to plead the elements of a securities law claim because the instruments were not securities and hence that the court lacked subject matter jurisdiction. The District Court ordered the parties to complete discovery on the sole question of whether the regulatory structure surrounding the institutions in question was sufficient to preclude the application of the securities laws to their instruments under *Marine Bank* v. *Weaver*, 455 U.S. 551 (1982). (App. 42a)

Following extensive discovery and supplemental briefing on the subject of regulation, the District Court held, by order dated January 2, 1987, that the Republic Trust instruments were not securities, but that the Republic Finance instruments were securities. (App. 36a) After analyzing the relevant state and federal regulatory systems, the Court held that (1) purchasers of the Republic Trust instruments were "abundantly protected by the Oklahoma Banking Department's regulation" because the Department's examination of Republic Trust was "very similar to the examination of banks and that the regulation was designed to protect purchasers" from insolvency (App. 40a) and (2) purchasers of the Republic Finance instruments were not abundantly protected because the Oklahoma Securities Commission's regulation was designed to provide adequate disclosure and not protection from the risk of Republic Finance's insolvency. (App. 40a) The District Court found that "FDIC insurance, or the lack thereof, is not the critical factor in determining the [required] abundance of protection." (App. 37a)

Defendants requested a clarifying order as to whether the "economic reality" test as first set forth in *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946), had been applied as to, *inter alia*, the Republic Finance analysis. In an order dated February 6, 1987 (App. 34a), the District Court concluded:

> "Considering the context of these instruments, the court finds these are investment securities rather than commercial promissory notes." (App. 35a) (citation omitted)

On March 3, 1987, the District Court issued an Amended Order and Judgment that: (1) entered final judgment pursuant to Fed. R. Civ. P. 54(b) against those plaintiffs who held Republic Trust instruments, dismissing their claims for lack of subject matter jurisdiction; (2) entered partial summary judgment on the question of subject matter jurisdiction against the defendants with respect to the Republic Finance plaintiffs; and (3) certified the question of whether the Republic Finance instruments were securities pursuant to 28 U.S.C. § 1292(b). (App. 31a)

Both plaintiffs and defendants appealed. By Order filed July 11, 1989, the Tenth Circuit affirmed in part and reversed in part, holding that both the Republic Finance and Republic Trust instruments were securities.[24] In considering whether purchasers of the thrift certificates and passbook savings accounts in question were "abundantly protected" for *Marine Bank* purposes, the Tenth Circuit held that

> "only federal regulation may be considered in the 'context' analysis [of *Marine Bank*.] [N]o amount of state regulation is sufficient to satisfy the *Marine Bank* standard." (App. 27a)

The court explicitly acknowledged that its decision in this respect was in conflict with those of other circuits. (App. 24a n.11) Considering only the Federal Reserve regulation under the Bank Holding Company Act, the Court of Appeals found that regulatory system inadequate to preclude application of the federal securities laws if they otherwise applied.

Separately, it applied the so-called commercial/investment dichotomy test, one of several tests in use among the courts of appeals to determine if notes or debt instruments are securities. The Tenth Circuit found the instruments in question to be investments and thus securities because, *inter alia*, they were offered to the public and used "as a vehicle for raising capital." (App. 16a) It declined to apply this Court's test in *SEC* v. *W.J.*

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24 The Court remanded to the District Court the issue of whether a single Republic Holding note qualified as a security. *See* n.23, *supra*.

Howey Co., *supra*, again recognizing that this put it in conflict with other circuits. (App. 18a-19a n.9)

A request for a stay of mandate pending the filing of this petition for *certiorari* was filed with the Tenth Circuit on July 28, 1989. No decision has yet been rendered on the motion; the mandate has not yet issued.

REASONS FOR GRANTING THE WRIT

I.

The Importance of the Issues Presented

This Court has but once addressed the question of whether certificates of deposit ("CDs") are securities for the purposes of the Securities Acts (*Marine Bank* v. *Weaver*, *supra*). It has never considered passbook accounts. Such certificates and accounts remain among the most common forms of public savings. The regulation of such instruments, in whatever institution the accounts and certificates are maintained, is a matter of extraordinary importance to the law—and to the public at large.

The court below, operating in an area of the law which this Court has itself described as both confusing and unsettled, *Landreth Timber Co.* v. *Landreth*, 471 U.S. 681, 688, 694 (1985), held that the passbook savings accounts and thrift certificates described above are "securities" for the purposes of the Securities Act of 1933, 15 U.S.C. § 77b(1) (1982), and the Securities Exchange Act of 1934, 15 U.S.C. § 78c(a)(10) (1982) (the "Securities Acts"). The Court of Appeals reached this conclusion by a two-step approach, each step of which yielded a result which it expressly acknowledged to be in direct conflict with decisions in other circuits. (*See* App. 18a and 24a, nn. 9 and 11.) This conflict in the circuits with respect to an important definitional issue of jurisdictional significance under the federal securities laws itself warrants review.

But the importance of the issues presented transcends the fact of crucial conflicts among the circuits as to definitions. The Tenth Circuit's analysis explicitly and entirely excludes all con-

sideration of state regulation, no matter how comprehensive, from the analysis mandated by this Court's decision in *Marine Bank* v. *Weaver*. It does so on a theory of federal "supremacy" over state law that is as wooden as it is irrelevant to evaluation of the adequacy of regulation in a field traditionally involving federal-state coordination and cooperation exemplified by the integrated federal-state regulatory efforts here. Thus, whether similar instruments, issued by similar institutions, will be deemed securities turns entirely on whether the principal regulator of the institution is a federal or state agency.

The practical consequences of this hostility to state regulation are profound both for securities regulation and for federal jurisdiction and judicial administration. There are hundreds of state-chartered institutions regulated primarily by States and not subject to FDIC or FSLIC insurance or oversight. They hold billions of dollars in general or trust deposits.[25] Each such

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25 The number of such institutions may be estimated by examining the number receiving general or trust deposits not insured by the FDIC or the FSLIC (and hence not subject to supervision by these federal entities). In 1988, in connection with the consideration of legislation relating to reform of the bankruptcy laws, the General Accounting Office ("GAO") conducted a telephone survey of various regulatory entities in an effort to determine the number of institutions uninsured by *either* federal or state insurance funds. That survey reflected deposits of more than $2.5 billion in institutions without either federal or state insurance maintained in approximately 100 domestic institutions. A larger number of foreign bank branches with uninsured deposits (of unspecified total) was also listed. *Results of General Accounting Office Survey to Identify Uninsured Financial Institutions That Accept Deposits From The Public* (April 1988).

Available published sources (for the most recent year available) for state-chartered institutions show even larger totals than the GAO's telephone survey. (Published figures are not available for some categories of similar institutions, and thus actual totals may be larger.) The published totals include the following:

Type of Institution	*Number of Institutions*	*Deposits*
S&L's without federal insurance (12/31/87)	261	$7.9 billion
Commercial banks without federal insurance (6/30/86)	45	$643 million
Industrial banks (1983)	654	$4.3 billion[a]

(*Footnote continued on next page*)

institution is potentially affected by this holding or by holdings in other circuits that might choose to follow the Tenth Circuit's lead. If this decision goes unreviewed, the impact on capital markets, securities regulation—and depositors—of rendering state-regulated institutions not supervised by the FDIC subject to the comprehensive provisions of the Securities Acts is likely to prove enormous. The potential expansion of federal jurisdiction over claims arising from the financial difficulties of uninsured thrifts and similar institutions is equally significant.

This expansion is all the more troubling because it is premised not only on ignoring state regulation altogether but on ignoring the plain language of the statutory definitions. The Congress which enacted those elaborate definitions into law was familiar with common terms such as "passbook account" and "certificate of deposit."[26] It used those very words in other statutes it enacted in the same session and it used "certificate of deposit for a security"—a very different concept—in the Securities Acts themselves. *See* 15 U.S.C. § 77b(1) (1982); 15 U.S.C. § 78c(a)(10) (1982). Its omission of those terms in the securities laws was part of a broader and deliberate separation of banking and securities legislation. The Tenth Circuit's holding threatens that separation at the very time Congress has begun to grapple

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[a] (The term "industrial banks" includes finance companies accepting deposits and institutions known variously as "industrial loan companies," "thrift and loan companies" and "industrial savings banks." Many of these institutions are uninsured or state-insured, but published statistics do not separately identify those that are federally insured.)

Sources: *Statistical Abstract of the United States*, No. 805 (1989) (S&L's); FDIC, *Databook*, Table 1 (1986) (commercial banks); American Financial Services Ass'n, *Industrial Banks as Thrift Institutions*, at 38-39 (1983) (industrial banks).

The Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (the "S&L Bailout Legislation") explicitly contemplates that a variety of institutions will continue to exist in the future without federal insurance. *See* § 222(h).

26 The district court recognized the instruments at issue here to be similar to certificates of deposit except for the fact that the latter were issued by banks. (App. 35a)

with a revision of regulation relating to various bank-like institutions such as savings and loan associations. *See* Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183. The Tenth Circuit's decision raises serious competing jurisdictional claims among securities and banking regulators as to authority over instruments offered to the public by state chartered entities.

For these reasons, explored more fully below, it is respectfully submitted that the Tenth Circuit's decision warrants review by this Court.

II.

The Tenth Circuit's Holding That State Regulation Is Wholly Irrelevant to Determining the Applicability of the Federal Securities Laws to the Instruments at Issue Here Is in Direct Conflict with Decisions in the Fourth, Fifth and Ninth Circuits and Presents Important Questions with Respect to the Regulation of State Chartered Financial Institutions and Federalism Generally

This Court considered the question of whether a bank certificate of deposit was a security in 1982. In *Marine Bank* v. *Weaver*, *supra*, it held that CDs issued by a state-chartered, federally regulated commercial bank were not securities. The CDs in question were insured for a portion of their face amount by the FDIC and hence were subject to supervision by that entity. 455 U.S. at 552-53. *Marine Bank* left open the question presented here of whether the instruments of banking and financial institutions regulated in whole or part by the states (and the Federal Reserve Board) but not by the FDIC (or FSLIC) are securities. We ask this Court to resolve that important question.

The *Marine Bank* decision did not analyze the CDs in question by reference to any of the various tests in use in the federal courts to determine if a given instrument is a security. Rather, relying on the Securities Acts' "unless the context otherwise requires" language, *see* 455 U.S. at 556, the Court formulated a standard for distinguishing depository instruments from securi-

ties. Noting that the CD in *Marine Bank* "was issued by a federally regulated bank which is subject to the comprehensive set of regulations governing the banking industry," the Court held that "[i]t is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws." 455 U.S. at 558-59 (footnote omitted).

This approach is consistent with the larger purposes of the Securities Acts. Where sufficient regulation is already in place federal securities legislation is not required. *See United Housing Foundation, Inc.* v. *Forman*, 421 U.S. 837, 849 (1975): "The primary purpose of the [Securities] Acts of 1933 and 1934 was to eliminate serious abuses in *a largely unregulated securities market*." (Emphasis added) No one could characterize the institutions at issue in *Marine Bank*—or here—as operating in an unregulated environment.

In *Marine Bank* the Court noted in particular that "[d]eposits in federally regulated banks are protected by the reserve, reporting, and inspection requirements of the federal banking laws; advertising related to the interest paid on deposits is also regulated." 455 U.S. at 558 (footnote omitted). These same interests were served by the state and federal regulatory systems surrounding the institutions in this case. The Tenth Circuit's analysis gave little weight to the federal analysis[27] and, most strikingly, rejected entirely any consideration of state regulation.

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27 The substantial federal regulation in place by itself, let alone in combination with the state regulation ignored by the Tenth Circuit, more than suffices to bring the instruments here within the reach of *Marine Bank*. Insurance aside, regulation by the Federal Reserve Board under the Bank Holding Company Act extended to each of the categories of regulation this Court deemed significant in *Marine Bank*, *i.e.*, "reserve requirements," "reporting requirements," "inspection requirements" and "advertising." *Compare Marine Bank*, *supra*, 455 U.S. at 558 n.8, with discussion of federal regulations, *supra* pp. 8-10. The Question Presented is intended to preserve this argument and, should certiorari be granted, both state and federal regulation will be argued as a basis for reversal.

Each of the other federal courts of appeals that has considered the matter has held (in conflict with the Tenth Circuit in this case) that the comprehensive regulation referred to in *Marine Bank* is *not* limited to federal regulation and that non-brokered[28] depository instruments issued by financial institutions subject to substantial state or other governmental regulation are not subject to the Securities Acts. *Tafflin* v. *Levitt*, 865 F.2d 595 (4th Cir.), *cert. granted on unrelated issue*, 109 S. Ct. 2428 (1989) (CDs of Maryland savings and loan association not "securities" given comprehensive state regulatory system); *West* v. *Multibanco Comermex, S.A.*, 807 F.2d 820 (9th Cir.), *cert. denied*, 482 U.S. 906 (1987) (Mexican bank CDs not "securities" in light of Mexican governmental regulation); *Callejo* v. *Bancomer, S.A.*, 764 F.2d 1101 (5th Cir. 1985) (same); *Wolf* v. *Banco Nacional de Mexico, S.A.*, 739 F.2d 1458 (9th Cir. 1984), *cert. denied*, 469 U.S. 1108 (1985) (same); *see also Brockton Savings Bank* v. *Peat, Marwick, Mitchell & Co.*, 577 F. Supp. 1281 (D. Mass. 1983) (bank jumbo CD not a "security").

The Tenth Circuit, in contrast, held that "no amount of state regulation is sufficient to satisfy the *Marine Bank* standard." (App. 27a) It reached this conclusion by means of a Supremacy Clause analysis not argued to it by any of the parties and grounded in the fundamentally inapposite case of *SEC* v. *Variable Annuity Life Ins. Co.*, 359 U.S. 65 (1959) (scope of 1933 Act registration exemption is federal question; certain "variable annuities" fall outside that exemption and the McCarran-Ferguson Act). By framing the question to be whether state regulation may ever "*displace*" the federal securities laws instead of focusing on whether Congress intended for the federal securities laws to reach the institutions or instruments in

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28 In *Gary Plastic Packaging Corp.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 756 F.2d 230, 240 (2d Cir. 1985), the court held that a "CD program" consisting of a package of CDs assembled by a broker and offering added benefits provided by the broker may be a security. The broker, of course, was not subject to regulation by any banking authorities.

question, the court turned *Marine Bank*'s analysis on its head.[29] The decision below, coupled with the conflicting Fourth, Fifth and Ninth Circuit decisions cited above, leads to the disturbing result that the very same instrument may be considered a security or not purely on the basis of the circuit in which its purchaser resides.

Given the divergent concerns of the banking laws and the securities laws, the superimposition of the Securities Acts on the state regulation of state-chartered banking and related financial institutions would necessarily interfere with such state banking regulation and, indeed, with the dual system of banking regulation. *See Gary Plastic Packaging Corp.* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, *supra*, 756 F.2d at 238 ("[a]lthough courts should construe the [federal securities] statutes broadly, because they are remedial, they should keep in mind that to afford the securities laws too wide a reach over banking institutions would overburden that already extensively regulated industry"); *American Bankers Ass'n* v. *SEC*, 804 F.2d 739, 745 (D.C. Cir. 1986) (Congress sought "to avoid duplicative regulation" as between the federal securities laws and banking regulation).

The Tenth Circuit's decision raises concerns not merely of duplication, but also of potential conflict created by tension between the traditional needs for confidentiality on the part of banks and the impetus of the securities laws towards full disclo-

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29 The Securities Act of 1933 contains striking internal evidence that Congress contemplated that *state* as well as federal banking regulation was relevant in assessing the proper reach of federal securities regulation. Congress specifically exempted from that statute's registration requirements any security (*e.g.*, stock) issued "by a savings and loan association, building and loan association, cooperative bank, homestead association, or similar institution, *which is supervised or examined by State or* Federal authority *having supervision over any such institution.*" Section 3(a)(5), 15 U.S.C. § 77c(a)(5) (Supp. V 1987) (emphasis added). *See also* 15 U.S.C. § 77c(a)(2) (1982). Plainly Congress envisioned a substantial state role in regulating banking—not a role in which federal supremacy would overwhelm state regulation or in which state regulation would be irrelevant to the reach of the federal securities laws.

sure.[30] The opinion below recognized these differing goals without considering the potential impact of conflicting regulation. (*See* App. at 25a, where the Tenth Circuit comments on the contrast between the disclosure goals of the securities laws and the "confidential, nonpublic nature of many of the lending and investment activities of financial institutions.") The contrasting regulatory aims suggest one reason that Congress chose to steer clear of bank regulation under the securities laws. The Tenth Circuit's decision is insensitive to that concern.

The burden the decision below would place on the federal courts also raises an important issue concerning Congressional intent and the proper resolution of the definitional issue. The expansion of federal subject matter jurisdiction has been a source of concern to this Court in this area. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 740 (1975). Expanding federal jurisdiction to encompass the claims here is unwarranted and threatens a significant expansion of federal litigation in light of the financial crises that have overtaken the thrifts and other state chartered financial institutions within the last few years.

Taken together, these factors make plain that the Tenth Circuit's approach to the institutions at issue and its interpretation of *Marine Bank* raise important questions that warrant review.

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30 The sometimes divergent concerns of federal securities and banking regulation were explicitly brought to the attention of this Court by the Solicitor General, representing the United States as *amicus*, in the *Marine Bank* case itself. Brief for the United States as *Amicus Curiae*, *Marine Bank* v. *Weaver*, 455 U.S. 551 (1982) (No. 80-1562). Representing both the SEC and several federal bank regulatory authorities including the Federal Reserve Board, the Solicitor General informed the Court that these federal agencies have frequently taken conflicting positions as to the application of the Securities Acts to various depository instruments. *Id.* at 2.

In this case the SEC filed a brief below in support of the position of respondents; the Federal Reserve Board did not file a brief.

III.

The Tenth Circuit's Decision Departs from This Court's Decisions in That It Failed to Consider That Neither the Language of the Securities Acts' Definitions Nor Their Legislative History Supports Treating Certificates of Deposit or Passbook Accounts as Securities

This Court has observed that in construing the Securities Acts' definition of the term "security," " '[t]he starting point in every case involving construction of a statute is the language itself.' " *Landreth Timber Co.* v. *Landreth*, *supra*, 471 U.S. at 685, *quoting Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 756 (Powell, J., concurring). Of course, to the extent this Court's decision in *Marine Bank* excluded the instrument from inclusion in the Acts altogether, the Tenth Circuit need not have considered the language itself. But in light of the fact that the Tenth Circuit rejected the applicability of *Marine Bank*, this Court's direction required that the more basic question of statutory language be considered by the lower court. The Tenth Circuit did not honor this approach.[31]

Congress' avowed purpose in enacting the definitional sections of the '33 and '34 Acts was to define "security" "in suffi-

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31 The Tenth Circuit's approach was focused on its perception as to the *need* for federal securities law protection.

The Seventh Circuit recently criticized this approach to the definition of securities—advanced before it by the SEC in the context of a jurisdictional dispute between the SEC and the Commodity Futures Trading Commission. The Seventh Circuit noted that:

> "the '34 Act and the [Commodity Exchange Act] define coverage by the attributes of the instrument rather than by the identity of those who own or trade it. This is the central message of *Landreth*, which at the SEC's urging rejected the 'sale of business doctrine' precisely because that doctrine disregarded the characteristics of the financial instrument in order to go straight to the question whether certain persons needed the protection of the law—*that is to say, whether coverage was a good idea.*" *Chicago Mercantile Exchange* v. *SEC*, Nos. 89-1538, 1763, 1786, 2012, 1989 U.S App. LEXIS 12994, at 39 (7th Cir. Aug. 18, 1989) (emphasis added).

Cf. Board of Governors of the Federal Reserve System v. *Dimension Financial Corp.*, 474 U.S. 361, 373 (1986).

ciently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall *within the ordinary concept of a security*," H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933) (emphasis added). Mindful of Congress' remedial purpose, this Court has, through the years been careful to include within the definition both the numerous instruments specifically listed "whose names alone carry well-settled meaning," *Landreth Timber Co.* v. *Landreth*, *supra*, 471 U.S. at 686, and "unusual instruments that [do] not fit squarely within one of the enumerated specific kinds of securities listed in the definition," *id.* at 690 n.4. These have usually been novel instruments that did not exist in 1933.

In cases decided by this Court holding that a given instrument was a security for the purposes of the Securities Act, the instrument was either specifically enumerated, *Gould* v. *Ruefenacht*, 471 U.S. 701 (1985) (stock); *Landreth Timber Co.* v. *Landreth*, *supra* (stock), or so novel or exotic that Congress could not have specified them in 1933. *See SEC* v. *Variable Annuity Life Ins. Co.*, *supra*, 359 U.S. at 76 (Brennan, J., concurring) ("variable annuities"—"a brand-new form of investment arrangement"); *SEC* v. *United Benefit Life Ins. Co.*, 387 U.S. 202 (1967) ("flexible fund annuities"); *Tcherepnin* v. *Knight*, 389 U.S. 332 (1967) ("withdrawable capital shares"); *SEC* v. *W.J. Howey Co.*, 328 U.S. 293 (1946) (citrus grove sales and service contracts); *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344 (1943) (oil and gas leases).

Certificates of deposit and passbook accounts do not fit either category. They are not identified as securities and yet were so well known to the drafters of the Securities Act that their exclusion cannot have been an oversight.[32] Their omission

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32 Indeed, two of the enumerated categories among the Securities Acts' definitions of "security" contain the phrase "certificate of deposit." Neither category encompasses the instruments at issue here. "Certificate of deposit for a security," added to the 1933 Act in 1934, refers to instruments issued by security holders' protective committees in the course of corporate reorganizations. *Marine Bank* v. *Weaver*, *supra*, 455 U.S. at 557 n.5. (The 1934 Act contains the same phrase, albeit with an additional comma of no signifi-

(*Footnote continued on next page*)

as enumerated categories in the definition of security can only be viewed as a conscious Congressional choice. More money was held in passbook accounts and certificates of deposit in 1933 than in any other category of instruments except stocks and bonds.[33] Indeed, the same Congress which enacted the first Securities Act in May of 1933 passed the Glass-Steagall Act (Act of June 16, 1933, Pub. L. No. 73-66, 48 Stat. 162 (codified throughout 12 U.S.C.)) less than a month later. The Glass-Steagall Act reflects that not only was Congress aware of the existence of passbook accounts and certificates of deposit, but that it understood that they were fundamentally different from securities. The Glass-Steagall Act made it unlawful

> "For any person, firm, corporation . . . engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a *passbook, certificate of deposit, or other evidence of debt*, or upon request of the depositor. . . ." 12 U.S.C. § 378(a)(1) (1982) (emphasis added).

(*Footnote continued from previous page*)

cance for the purposes of interpretation, *Canadian Imperial Bank of Commerce Trust Co.* v. *Fingland*, 615 F.2d 465, 468 n. 8 (7th Cir. 1980)). This narrow use of the phrase underscores Congress' intent *not* to cover certificates of deposit generally. *Id.* at 468 (had Congress wanted to, "Congress could have expressly included all certificates of deposit by eliminating 'for a security' and thus could have included certificates representing currency deposits as well as security deposits"). The second use of the phrase, added in 1982, referring to any "put, call," etc. on a certificate of deposit, again evidences the striking omission of reference to CDs in themselves as securities. *See* Jacobs, *The Meaning of "Security" Under Rule 10b-5*, N.Y.L. Sch. L. Rev. 211, 331 (1984).

33 U.S. Census Bureau, *Historical Statistics of the United States* at 253, 992, 1058 (1975); as of June 1933, more than 39 million depositors held savings accounts and certificates of deposit totalling $21,424,226,000.00. *New York Times*, Dec. 1, 1933, p. 30, col. 8.

It defies belief that the same Congress which enacted this legislation using the very terms "passbook" and "certificate of deposit" would have omitted passbook accounts and certificates of deposit from the Securities Act's definition of "security" had it intended that term to encompass such instruments.

Indeed, there is no indication whatever in the legislative history of the Securities Acts that Congress intended thereby to regulate the ordinary deposit and passbook activities of banking and financial institutions under the Securities Acts.[34] The Securities Acts were drafted, discussed and enacted with full awareness of the terms of the Glass-Steagall Act; the legislative history of both acts shows that Congress intended that securities and banking activities be regulated separately and differently.[35]

Congress intended that the securities and banking industries be treated as separate compartments since many saw the intermingling of the two industries as the source of the financial problems Congress sought to address. *Board of Governors of Federal Reserve System* v. *Investment Company Institute*, 450 U.S. 46, 61-62 (1981) (legislative goal of separating securities business from banking business was result of perception that intermingling of commercial and investment banking had contributed to rash of bank failures). With this background, the

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34 The legislative history of the exemptions for bank or S&L "securities" emphasizes the point that there was no intention to include passbook accounts or certificates of deposit within the reach of the term securities—even for the purpose of exempting them. Thus, in a discussion of the provisions exempting bank securities from the coverage of the Securities Act of 1933, a draftsman of the Act was asked what securities banks issued. His response: "I do not suppose a national bank would be putting out anything in addition to its capital stock." No reference was made to passbooks, certificates of deposit or the like. *Federal Securities Act: Hearing on H.R. 4314 Before House Comm. on Interstate and Foreign Commerce*, 73d Cong., 1st Sess. 31 (1933) (testimony of Huston Thompson). (The national bank and savings and loan association exemptions are reflected in 15 U.S.C. § 77c(a)(2) (1982) and 15 U.S.C. § 77c(a)(5) (Supp. V 1987), respectively.)

35 Various definitions (*e.g.*, "bank") in the 1934 Act reflect "a purposeful decision on [Congress'] part that the SEC should not have oversight jurisdiction with respect to banks, because banks were already subject to a complex scheme of administrative regulation at the federal and state level." *American Bankers Ass'n* v. *SEC*, *supra*, 804 F.2d at 744.

striking omission of common terms such as "certificate of deposit" and "passbook" from the Securities Acts' definitions demonstrates with clarity the dual-track Congressional approach. Instruments like passbook accounts and CDs were not to be subject to the federal securities laws but were to be separated from the securities industry and controlled by whatever legislation was to be put in place to deal directly and specifically with banks and banking institutions. The Tenth Circuit's approach wholly fails to come to grips with the statutory language and history and in so doing fails to honor this Court's express concern that the language of the securities statute be given effect.[36] To rectify this departure from this Court's decisions—a departure with broad consequences for institutions with billions of dollars in deposits (*see* Points I and II, above)—the decision below should be reviewed.

IV.

The Tenth Circuit's Analysis of the Instruments at Issue as "Notes" Is Inconsistent with That of Other Circuits and Yielded a Result in Direct Conflict with the Eighth Circuit's Decision in *Reves* v. *Arthur Young & Co.* as to Which This Court Has Recently Granted *Certiorari*

The Tenth Circuit, while recognizing that the instruments at issue here were not explicitly included in the definition of a security, found the "note" and "evidence of indebtedness" categories in the statutes "sufficiently ambiguous to merit an inquiry" as to coverage of the present instruments. (App. 10a) The Tenth Circuit's decision to treat the instruments here as just another form of debt or note obligation is, as discussed in Point III above, fundamentally at odds with the language of the definition, the statutory context (*i.e.*, the fact that where Con-

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36 Of course, the label annexed to an instrument does not end the inquiry and a label may not be used to disguise the real character of an instrument. *Cf. Marine Bank, supra*, 455 U.S. at 560 n.11. Here, however, an examination of the instruments and the "context" surrounding them reveals that the name used is reflective of the very kinds of instruments that, as shown above, Congress intended to exclude from coverage.

gress intended such instruments to be lumped together with other "evidence of debt" it so specified, *e.g.*, 12 U.S.C. § 378(a)(1) (1982)) and the broader context of the relevant legislative history. The particular test to be applied to determine whether a "note" was a security, is, in any event, one as to which the circuits are divided.

The Tenth Circuit applied the commercial/investment dichotomy test in use in several circuits.[37] This test purports to distinguish commercial transactions which the securities laws were not meant to regulate, from investment transactions. As applied by the Tenth Circuit it involves consideration of eight separate criteria,[38] but, in fact, the court below ignored several of the criteria, noted that under others the instruments would not be securities, and focused on three so general as to bring any depository instruments within the definition of a security, including those this Court held not to be securities in *Marine Bank*.[39] (App. 12a-17a) Its analysis demonstrated the basic lack of utility in applying this approach to the *sui generis* category of bank and bank-like deposits.

The court below expressly rejected the use of a second test, that set forth by this Court in *SEC* v. *W.J. Howey Co.*, *supra*, 328 U.S. at 298-99, because that test's requirement of "capital appreciation" or "participation in earnings," *United Housing*

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37 *See, e.g.*, *Futura Development Corp.* v. *Centex Corp.*, 761 F.2d 33, 40-41 (1st Cir.), *cert. denied*, 474 U.S. 850 (1985); *Lino* v. *City Investing Co.*, 487 F.2d 689, 693-95 (3d Cir. 1973); *McClure* v. *First Nat'l Bank*, 497 F.2d 490, 494-95 (5th Cir. 1974), *cert. denied*, 420 U.S. 930 (1975); *Hunssinger* v. *Rockford Business Credits, Inc.*, 745 F.2d 484, 489 (7th Cir. 1984); *Zabriskie* v. *Lewis*, 507 F.2d 546, 550-51 (10th Cir. 1974).

38 Prof. Loss has characterized the commercial/investment test as beset by "a certain degree of analytical imprecision," noting that "[w]hile the courts have shown considerable facility in adumbrating the criteria to be considered . . . they have been considerably less successful in theorizing how these criteria might be ordered or weighted." 2 L. Loss & J. Seligman, *Securities Regulation* at 881-82 (3d ed. 1989).

39 The three criteria on which the court below relied were (1) whether the instruments were offered to the general public, (2) whether the instruments were on occasion denominated "investments" and (3) whether "the instruments were issued as a vehicle for raising capital." (App. 13a-16a) The instruments in *Marine Bank* would satisfy all three tests as applied below.

Foundation v. *Forman*, *supra*, 421 U.S. at 852, would exclude all debt instruments from being securities. (App. 18a) The Eighth Circuit, in contrast, recently relied, in substantial part, on this very test to find that certain demand notes resembling depository instruments issued by a farmer's cooperative were not securities. *Arthur Young & Co.* v. *Reves*, 856 F.2d 52, 53 (8th Cir. 1988), *cert. granted*, 109 S. Ct. 3154 (1989) (No. 88-1480). Both the method employed and the result arrived at in *Reves* are in direct conflict with the decision of the Tenth Circuit, as it itself recognized. (App. 18a-19a n.9) *Cf. Schlifke* v. *Seafirst Corp.*, 866 F.2d 935, 941-42 (7th Cir. 1989), cited by the Tenth Circuit as utilizing the *Howey* test. *Id.*

The Second and Ninth Circuits use still other tests to determine whether notes are securities. Under the Ninth Circuit's "risk capital" test, the bulk of instruments at issue (as well as the demand notes in *Reves*) would not be considered securities given their demand or short-term characteristics. *Great Western Bank & Trust* v. *Kotz*, 532 F.2d 1252, 1257-58 (9th Cir. 1976) (per curiam) ("A demand or short-term note is almost *ipso facto* not a security unless payment is dependent upon the success of a risky enterprise, or the parties contemplate an indefinite extension of the note or perhaps conversion to stock").[40] Neither would the bulk of the instruments in question be securities under the Second Circuit's "literal approach," *Exchange Nat'l Bank* v. *Touche Ross & Co.*, *supra*, also implicitly rejected by the court below. This approach calls for attention to the literal language of the 1934 Act, which, unlike the 1933 Act, by its terms excludes "any note . . . which has a maturity at the time of issuance of not exceeding nine months." 15 U.S.C.

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40 The six factor "risk capital" test used by the Ninth Circuit was criticized in *Exchange Nat'l Bank* v. *Touche Ross & Co.*, 544 F.2d 1126, 1137 (2d Cir. 1976):

> "Directing district courts to 'weigh' a number of such dubious factors, without any instructions as to relative weight and with admonitions such as given by the *Great Western per curiam*, is scarcely helpful to hard-pressed district judges or to counsel." (Footnote omitted)

§ 78c(a)(10).[41] Although the Second Circuit sets a number of exceptions to the literal approach, none of them comes close to making the instruments at issue here securities. *See Exchange Nat'l Bank* v. *Touche Ross & Co.*, *supra*, 544 F.2d at 1137.

Given the direct conflict between the holding of the court below and that of the Eighth Circuit in *Reves* and the general confusion among the courts of appeals as to the standard to be used to determine what debt instruments are securities, the Court should resolve both the direct and general conflicts among the courts of appeals and specify the proper test to be employed if the instruments are to be reviewed under the general note definition.

Like *Reves*, this case presents what are essentially demand notes which are also depository instruments. Unlike *Reves*, this case also presents a variety of instruments with fixed maturities, ranging from three months to three years. Also unlike *Reves*, this case presents a case of comprehensive state and federal regulation. Because demand notes are but a special case of "notes", and because this case presents circumstances involving significant governmental regulation the facts of this case would provide a useful supplement to those in *Reves*.

Certiorari was granted on June 13, 1989 in *Reves*. 109 S. Ct. 3154. We are informed that, as of the date of this petition, no date has yet been set for argument. The pendency of *Reves* before this Court presents a distinct basis for granting review of this matter. We respectfully urge that the Court grant *certiorari* and consider setting this matter down for argument with *Reves*.[42]

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41 The United States and the SEC, as *amici* in the *Reves* case, urge this Court to adopt what they refer to as the Second Circuit's "family resemblance" test because "[i]n focusing on the statutory language," that test "provides useful guidance and a degree of certainty." Brief for the United States and the Securities and Exchange Commission as *Amici Curiae* on Petition for a Writ of *Certiorari*, *Reves* v. *Arthur Young & Co.* (No. 88-1480), at 17-18. Those *amici* urge this Court to reject the other "note" tests, including the test employed by the Tenth Circuit. *Id.* at 18.

42 We recognize that the Court might consider deferring consideration of this petition pending disposition of *Reves*. Because this case presents significant issues (discussed in Points I, II and III) that go far beyond those raised by *Reves* and will likely not be addressed by any decision in that case we urge that *certiorari* be granted independently in this case as well.

CONCLUSION

For the foregoing reasons the petition for a writ of *certiorari* should be granted.

Dated: New York, New York
September 29, 1989

Respectfully submitted,

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APPENDIX

PUBLISH

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Nos. 87-1486, 87-1490

FILED July 11, 1989

W. DAVID HOLLOWAY, M.D.; LISA HOLLOWAY; CHARLES WOODARD; LINDA WOODARD; MAXINE BLACK, individually and as Trustee for James T. Black and Shellie Black; PORTER-STRAIT INSTRUMENT CO., INC., an Oklahoma corporation; JEREMY K. BUSH; SHIRLEY BUSH; UNITED RESOURCES BUILDING COMPANY, INC., an Oklahoma corporation; HUGH HOLLOWELL; MARSHALL H. UDDEN; MARY F. UDDEN; HOWARD R. CADWELL; DORIS G. CADWELL; WILLIAM L. AKERS; NORITA L. AKERS; CAL ACREE; BETTY K. ACREE; ROBERT JOHN WALPOLE; BOBBEE C. RAY, individually and as Trustee for James F. Haning, II and Angela Jean Haning Revocable Trust and Victoria Nininger; JOY A. DONOVAN, as Trustee for James M. Donovan and John A. Donovan; R.H. ARNOLD; MARVELLE MCDANIEL; MARTHA HESTER ARNOLD; CLAUDETTE HOWE; FRED E. MILLER; VERA MILLER; BEVERLY JOYCE MILLER; ANN MCLOUD; JOYCE MCCLURE; CHARLOTTE A. BROAD, individually and as Trustee for Russell M. Gawf and Megan D. Gawf; JOHN E. BROAD; JOHN W. BROAD; DEWAYNE BROAD, for themselves and as representative parties of class,

Plaintiffs/Appellees/Cross-Appellants,

v.

PEAT, MARWICK, MITCHELL & CO., a partnership; SUNBELT BANK & TRUST COMPANY, formerly Republic Bank &

Trust Co., a State Bank Association; WESLEY R. MCKINNEY, individually; PHILLIPS BRECKINRIDGE, Administrator of the Estate of Glenn F. Prichard, Deceased; RBI OF OKLAHOMA, INC., a Delaware corporation; R.R. BASTIAN, III; HAL W. OSWALT; HAROLD J. BORN; WILLIAM J. DOYLE, JR.; HORACE H. PORTER, M.D.; WILLIAM W. RAMSEY; EDWARD B. WILCOX; ALTUS E. WILDER, III; G. LARRY YOUNG; ORVILLE J. BERTALOT; TED C. BODLEY; KEITH E. MCNEAL; EDWARD L. TAYLOR; CHARLES G. WRAY; ANSIL LUDWICK, JR.; PAUL W. ANDERSON, JR.; G. RICHARD DEGEN; BROWN J. AKIN, JR.; ROBERT C. BATES; RICHARD G. BELL; BOB C. LAMIRAND; DOUGLAS W. DIXON; RODNEY MILLER; DAN W. ALLRED; TIMOTHY J. SULLIVAN; DWIGHT A. PILGRAM; ROGER H. LAUBACH; JAMES D. ESSIG; MARTHA J. CRAVENS; WILMA F. WOOD; CHARLES SCHUSTERMAN; RICHARD WILLIFORD; REPUBLIC BANCORPORATION, INC., also known as Sunbelt Bancorporation, Inc., an Oklahoma corporation,

Defendants/Appellants/Cross-Appellees.

APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
NORTHERN DISTRICT OF OKLAHOMA
(D.C. No. 84-C-814-EU)

Lawrence H. Eiger (Michael B. Hyman and Steven A. Kanner, of Much, Shelist, Freed, Denenberg, Ament & Eiger, P.C., of Chicago, Illinois; Steven E. Smith, of Steven E. Smith & Associates, of Tulsa, Oklahoma; Charles O. Hanson, Richard K. Holmes, and Stewart E. Field, of Hanson, Holmes, Field & Snider, of Tulsa, Oklahoma; and Professor Joseph C. Long, of the University of Oklahoma, College of Law, Norman, Oklahoma, with him on the briefs), of Much, Shelist, Freed, Denenberg, Ament & Eiger, P.C., of Chicago, Illinois, for the Plaintiffs/Appellees/Cross-Appellants.

L. K. Smith (Kimberly A. Lambert, of Boone, Smith, Davis & Hurst, of Tulsa, Oklahoma, with him on the briefs), of Boone, Smith, Davis & Hurst, of Tulsa, Oklahoma, for all the Defendants/Appellants/Cross-Appellees except Peat, Marwick, Mitchell & Co.

Graydon Dean Luthey, Jr. (Deryl L. Gotcher and Roy C. Breedlove, of Jones, Givens, Gotcher, Bogan & Hilborne, a Professional Corporation, of Tulsa, Oklahoma; and Anthony J. Costantini, Associate General Counsel, of Peat, Marwick, Main & Co., of New York, New York, with him on the briefs), of Jones, Givens, Gotcher, Bogan & Hilborne, a Professional Corporation, of Tulsa, Oklahoma, for the Defendants/Appellants/Cross-Appellees Peat, Marwick, Mitchell & Co.

Daniel L. Goelzer, General Counsel, Jacob H. Stillman, Associate General Counsel, Rosalind C. Cohen, Assistant General Counsel, and Batya Roth, Attorney, of the Securities and Exchange Commission, of Washington, D.C., *amicus curiae.*

Before McKAY, BARRETT, and TACHA, *Circuit Judges.*

TACHA, *Circuit Judge.*

The issue presented in this interlocutory appeal is whether certain instruments issued by three Oklahoma entities—Republic Bancorporation, Inc. (RBI), and its two nonbank subsidiaries, Republic Trust & Savings (RTS), a trust company, and Republic Financial Corporation (RFC), a finance company—are securities within the meaning of the federal securities laws. We hold that the instruments issued by RFC and RTS are securities. However, because material issues of fact remain regarding RBI's issuance of a note, we remand to the district court for further consideration of whether that note is a security. Therefore, we affirm in part, reverse in part, and remand.

I.

Until 1984 RBI was a bank holding company regulated by the Federal Reserve Board (FRB). In addition to controlling RTS and RFC, RBI also controlled a state-chartered bank, Republic Bank & Trust Company (RBT). In 1984 RBI effectively divested RBT pursuant to an order from the FRB, thereby becoming a nonbank holding company that was outside the scope of federal banking regulation.[1] After divesting the bank, RBI continued to control RTS and RFC. Soon after the divestiture, RBI, RTS, and RFC all filed for bankruptcy.

The plaintiffs in this case invested money with RTS and RFC and received in return "thrift certificates" and "passbook savings certificates." In addition, RBI reissued to one of the plaintiffs a promissory note that had originally been issued by its subsidiary bank. The plaintiffs allege that through issuing these instruments, the issuing entities and their accounting firm sold, or aided and abetted the sale of, securities in violation of the antifraud provisions of the federal securities laws.

The defendants filed motions to dismiss, arguing that the instruments are not securities within the meaning of the federal securities laws and that therefore the district court lacked subject matter jurisdiction. The district court converted the motions to dismiss to motions for partial summary judgment on the issue of subject matter jurisdiction, and directed the parties to conduct discovery and submit briefs on the issue of government regulation of the three organizations.

After examining the regulatory structure applicable to each of the issuing entities and considering the broad definition of

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1 This account of the divestiture has been somewhat simplified. The actual details are set forth in *In re Republic Trust & Savings Co.*, 59 Bankr. 606, 607-08 (Bankr. N.D. Okla. 1986), *appeal denied, In re Republic Financial Corp.*, 77 Bankr. 282 (N.D. Okla. 1987). In 1984 RBI (old RBI) changed its name to Sunbelt Bancorporation, Inc., while a separate entity at that time known as Sunbelt Bancorporation, Inc. changed its name to Republic Bancorporation, Inc. (new RBI). *Id.* at 608. Old RBI transferred RTS and RFC to new RBI, while retaining ownership of the state-chartered bank. *Id.* "Neither old RBI nor new RBI held any significant ownership interest in each other." *Id.* For the purposes of this opinion, "RBI" simply refers at all times to the corporate parent of RTS and RFC.

securities under the federal securities laws, the district court held that the instruments issued by RTS were not securities, but that those instruments issued by RFC, and the note issued by RBI, were securities. The court therefore granted the defendants' motion for summary judgment with respect to the RTS instruments and the plaintiffs' motion for summary judgment as to the RBI and RFC instruments. Both the plaintiffs and the defendants appealed.

II.

When reviewing a grant of summary judgment, we must determine whether any genuine issue of material fact remains and, if not, whether the district court correctly applied the law. *Franks v. Nimmo*, 796 F.2d 1230, 1235 (10th Cir. 1986). The district court correctly determined that only legal issues remain with regard to the instruments issued by RFC and RTS. Thus, we proceed to decide whether the court correctly determined whether those instruments, consisting of passbook savings certificates and thrift certificates, are securities. We employ a de novo standard of review for this question of law. *See Carey v. United States Postal Serv.*, 812 F.2d 621, 623 (10th Cir. 1987).

We first consider whether any of the instruments in question fall within the statutory definition of a security. The Securities Exchange Act of 1934 provides:

> (a) Definitions
>
> When used in this chapter, *unless the context otherwise requires*—
>
> . . . .
>
> (10) The term "security" means *any note*, stock, treasury stock, *bond*, *debenture*, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any

> interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; *but shall not include currency or any note*, draft, bill of exchange, or banker's acceptance *which has a maturity at the time of issuance of not exceeding nine months*, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

15 U.S.C. § 78c(a)(10) (emphasis added). The definition of "security" in the Securities Act of 1933 is slightly different in that it also includes the term "evidence of indebtedness." *See* 15 U.S.C. § 77b(1). Despite this difference, the Supreme Court has "consistently held that the definition of 'security' in the 1934 Act is essentially the same as the definition of 'security' in § 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1)." *Marine Bank v. Weaver*, 455 U.S. 551, 555 n.3 (1982); *see also United Hous. Found., Inc. v. Forman*, 421 U.S. 837, 847 n.12 (1975) (definition of security in 1933 and 1934 Acts are "virtually identical").

When determining whether an instrument falls within the scope of the definitional statute, the Supreme Court has repeatedly stated that the definition of a security should be broadly construed because the federal securities laws are remedial legislation.[2] *Id.* at 847-48; *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963); *see also Marine Bank*, 455 U.S. at 555-56.

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2 At least one commentator has remarked upon the broad interpretation of the securities laws by way of listing examples:

> What do the following have in common: scotch whiskey, self-improvement courses, cosmetics, earthworms, beavers, muskrats, rabbits, chinchillas, fishing boats, vacuum cleaners, cemetery lots, and fruit trees? The answer is that they have all been held to be securities within the meaning of federal or state securities statutes. T. Hazen, *The Law of Securities Regulation* § 1.5, at 14 (1985) (footnotes omitted).

> In providing [the definition of a security] Congress did not attempt to articulate the relevant economic criteria for [distinguishing] "securities" from "non-securities." [R]ather, it sought to define "the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a security."

Forman, 421 U.S. at 847-48 (quoting H.R. Rep. No. 85, 73d Cong., 1st Sess. 11 (1933)); *see also Marine Bank*, 455 U.S. at 555-56.

The remedial purpose that Congress intended to accomplish through the securities laws is the protection of investors:

> The [1933 and 1934 Acts] were designed to provide investors with material information and to protect the investing public from the sale of worthless securities through misrepresentation. The legislation was intended to encourage "honest dealing in securities and thereby bring back public confidence" in the investment markets and to eliminate the "unethical and unsafe practices of bank and corporate officers."

Gary Plastic Packaging Corp. v Merrill Lynch, Pierce, Fenner & Smith, Inc., 756 F.2d 230, 237 (2d Cir. 1985) (citations omitted) (quoting Letter from President Franklin D. Roosevelt to Congress (March 29, 1933), *reprinted in* 77 Cong. Rec. 937 (1933)). The federal securities laws are designed "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *Capital Gains Research Bureau*, 375 U.S. at 186.

We apply the language of the definitional statutes to the instruments issued by RTS and RFC in light of the remedial purpose of the federal securities laws. The terms "passbook savings certificates" and "thrift certificates" do not expressly appear in either of the definitional statutes, but this does not prevent such instruments from being securities. We must con-

sider the substance of the instrument rather than the form. *Tcherepnin*, 389 U.S. at 336.

> [I]f any inquiry other than whether the instrument fits the statutory definition is appropriate, it would be whether the instrument and transaction fit the traditional characteristics of the defined term, or whether . . . the reasons and policies that gave rise to protection of securities under the 1933 and 1934 Acts are applicable.

Penturelli v. Spector, Cohen, Gadon & Rosen, 779 F.2d 160, 167 (3d Cir. 1985) (citation omitted); *accord Adena Exploration, Inc. v. Sylvan*, 860 F.2d 1242, 1248 (5th Cir. 1988).

Here, both the passbook savings certificates and thrift certificates are essentially debt instruments, representing a promise by the issuing entity to repay the principal amount, plus accrued interest at a specified rate, within a specified time period or on demand.[3] These instruments will therefore be analyzed under the "notes" or "evidence of indebtedness" categories of the statutory definition of "security."[4] *See Sanderson v. Roethenmund*, 682 F. Supp. 205, 206 (S.D.N.Y. 1988) (holding that "international certificates of deposit" evidencing "a promise to pay a specified sum of principal and interest to the payee at a

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3 Both RFC and RTS reserved the right to subject holders of passbook savings certificates and thrift certificates to additional conditions upon demand for repayment: 1) thirty days written notice could be required prior to redemption; and 2) redemptions of certificates in any given calendar month could be limited to fifty percent of the net cash flow of the preceding month.

4 Although federal law clearly governs whether such instruments are securities, *see Tcherepnin*, 389 U.S. at 337-38, our characterization of these instruments is also consistent with Oklahoma law, which permits a trust company, such as RTS, "[t]o issue debentures, notes, or other evidences of debt in the manner in which business corporations are authorized to do so." Okla. Stat. Ann. tit. 6, § 1001(22) (West 1984). The instruments issued by RTS were not certificates of deposit, but certificates of indebtedness because RTS was not a bank and therefore lacked the power to accept deposits. *In re Republic Trust & Sav. Co.*, 59 Bankr. 606, 612-13 (Bankr. N.D. Okla. 1986), *appeal denied, In re Republic Fin. Corp.*, 77 Bankr. 282 (N.D. Okla. 1987). We see no reason to treat the instruments issued by RFC, a finance company, any differently as it also is a nonbank institution under Oklahoma law. *See In re Republic Fin. Corp.*, 77 Bankr. 282, 284 (N.D. Okla. 1987).

specified time" were to be analyzed as "notes" for purposes of the 1933 and 1934 Acts); *cf. Bradford v. Moench*, 670 F. Supp. 920, 922, 932-33 (D. Utah 1987) (noting that functional analysis of instruments must be applied to determine if "thrift certificates" or "saving passbook or other accounts" of state-chartered financial institution are securities).

Merely identifying these instruments as "notes" or "evidence of indebtedness" does not end our analysis, however, because the phrase "unless the context otherwise requires," precedes the definition of "security" in the statute itself. Thus, Congress has specifically directed an analysis that goes beyond the literal application of the definitional section.[5]

The Supreme Court has recognized two general circumstances in which the context of the underlying transaction could override the literal language of the statute. First, when the category utilized in the definitional statute is sufficiently ambiguous to raise the question whether Congress would have intended to include all such instruments on the basis of the face of the instrument alone, the Court permits an inquiry into the factual circumstances underlying the transaction. *See Landreth*, 471 U.S. at 693-94; *see also Marine Bank*, 455 U.S. at 556, 560 n.11. This inquiry involves "what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect." *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 352-53

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5 Two circuit courts have held that the "context" language prefacing the definitional provisions of the 1933 and 1934 Acts refers only to the context in which a definitional term appears within the statute, and not to the context of the underlying transaction. *See American Bankers Ass'n v. SEC*, 804 F.2d 739,753-54 (D.C. Cir. 1986); *Ruefenacht v. O'Halloran*, 737 F.2d 320, 330-32 (3d Cir. 1984), *aff'd sub nom. Gould v. Ruefenacht*, 471 U.S. 701 (1985).

The Supreme Court has not yet explicitly rejected this position, but it certainly has inquired beyond the four corners of the statute in determining whether a particular financial instrument is a security. *See Marine Bank v. Weaver*, 455 U.S. 551, 556-59 (1982) (relying in part upon the "context" of federal regulation of banks in holding that certificates of deposit were not securities). Subsequent to *Marine Bank* the Court has continued to inquire into the "context" of the underlying transaction. *See Landreth Timber Co.*

(1943); *accord Marine Bank*, 455 U.S. at 556; *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 211 (1967).

Second, when the issuing entity is pervasively regulated by another federal regulatory scheme, the Court has inquired into whether such alternative federal regulation accomplishes the same purposes as the securities laws, thereby making the securities laws' protections for investors duplicative and unnecessary. *See Marine Bank*, 455 U.S. at 557-59; *International Bhd. of Teamsters v. Daniel*, 439 U.S. 551, 569-70 (1979). Both of these "context" inquiries are potentially relevant to the instruments in this case, and we consider them in turn.

A.

The "note" and "evidence of indebtedness" categories are sufficiently ambiguous to merit an inquiry into the factual context of the issuance of such instruments. *See Zabriskie v. Lewis*,

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v. Landreth, 471 U.S. 681, 687 (1985) ("context of the transaction involved here—the sale of stock in a corporation—is typical of the kind of context to which the [securities] Acts normally apply"). Although the Court held in *Landreth* that an inquiry into "the economic reality underlying the transactions" was not necessary in all cases involving the sale of "stock," *id.* at 690-91, it expressly left open the question "whether coverage of notes or other instruments may be provable" on the basis of their name and characteristics alone, *id.* at 693, 694. The Court explicitly stated that " 'stock' may be viewed as being in a category by itself for purposes of interpreting the scope of the Acts' definition of 'security.' " *Id.* at 694. Furthermore, the Court specifically noted that " 'note' may now be viewed as a relatively broad term that encompasses instruments with widely varying characteristics, depending on whether issued in a consumer context, as commercial paper, or in some other investment context." *Id.*

The circuit courts in *American Bankers Association* and *O'Halloran* suggested that reliance upon the "context" clause was unnecessary to the Court's holding in *Marine Bank* because the legislative history and structure of the securities acts also supported the result. *American Bankers Ass'n*, 804 F.2d at 753-54 & n.23; *O'Halloran*, 737 F.2d at 331 n.29. Although we agree that the context of the underlying transaction cannot be used to contradict the intent of Congress as contained in the legislative history and structure of the Acts, we do not interpret *Landreth* or *Marine Bank* to restrict the scope of our consideration in this case to the statutory text or legislative history alone.

507 F.2d 546, 550-51 (10th Cir. 1974); *cf. Landreth*, 471 U.S. at 693-94 (declaring that earlier statement by Court equating " 'notes' . . . with 'stock' as categories . . . standardized enough to rest on their names" was to be characterized as "dictum"). The term "note" is "viewed as a relatively broad term that encompasses instruments with widely varying characteristics, depending on whether issued in a consumer context, as commercial paper, or in some other investment context." *Id.* at 694 (citing *Securities Indus. Ass'n v. Board of Governors of the Fed. Reserve Sys.*, 468 U.S. 137, 149-53 (1984)).

Accordingly, the literal language of the 1934 Act—"[a security includes] any note . . . but shall not include . . . any note . . . which has a maturity at the time of issuance of not exceeding nine months," 15 U.S.C. § 78c(a)(10)—cannot be read literally to include or to exempt "any note" based on maturity alone. *See Zabriskie*, 507 F.2d at 550. In establishing the coverage of the securities laws, Congress neither intended to include all notes with maturities greater than nine months nor to exclude all notes with maturities less than nine months. *See id.* The exemption for short-term notes is limited to " 'prime quality negotiable [commercial] paper of a type not ordinarily purchased by the general public, that is, paper [issued] to facilitate well recognized types of current operational business requirements and of a type eligible for discounting by Federal Reserve banks.' " *Id.* (quoting Securities Act Release No. 4412, 26 Fed. Reg. 9158, 9159 (1961)); *see also United States v. Roylance*, 690 F.2d 164, 168-69 (10th Cir. 1982).

The maturity of a note is therefore not dispositive. Instead, the commercial or investment character of the underlying transaction determines whether an instrument is a security.

> [T]he [1934] Act covers all *investment* notes, no matter how short their maturity, because they are not encompassed by the "any note" language of the exemption. On the other hand, the Act does not cover any *commercial* notes, no matter how long their maturity, because they fall outside the "any note" definition of a security. . . . [T]he investment or commercial nature of a note entirely

> controls the applicability of the Act, depriving of all utility the exemption based on maturity-length.

McClure v. First Nat'l Bank, 497 F.2d 490, 494-95 (5th Cir. 1974) (emphasis in original), *cert. denied*, 420 U.S. 930 (1975); *see Matek v. Murat*, 862 F.2d 720, 727 n.11 (9th Cir. 1988) ("Especially in the area of commercial notes, a literal reading of the securities acts may not be appropriate."); *Smith Int'l, Inc. v. Texas Commerce Bank*, 844 F.2d 1193, 1199 n.4 (5th Cir. 1988) ("[I]t is simply too late in the day to successfully contend that the literal statutory definitions of themselves mean that it can always be reasonably argued that *any* note (or any for more than nine months) is a security no matter what the circumstances.") (emphasis in original).

This circuit has utilized the commercial/investment dichotomy in evaluating whether notes or similar debt instruments fall within the definition of security. *See McVay v. Western Plains Serv. Corp.*, 823 F.2d 1395, 1399 (10th Cir. 1987) (loan participations); *McGovern Plaza Joint Venture v. First of Denver Mortgage Investors*, 562 F.2d 645, 647 (10th Cir. 1977) (loan commitments); *Zabriskie*, 507 F.2d at 551 (promissory notes). The commercial/investment test

> is based on the purpose of the Act to protect investors, the "unless the context otherwise requires" language, and the practical considerations of subjecting commercial notes to the registration provisions of the Securities Act as well as fear of the resulting litigation flooding the federal courts if commercial notes were included. The test accords with the exalting of economic reality over form, and seeks to protect investors.

Id. (citation omitted).

In *Zabriskie*, the court cited with approval a number of factors that one commentator had suggested "could assist in the final determination that an investment note (a security) is or is not present." *Id.* at 551 n.9. The factors include:

> (1) use of proceeds to buy specific assets or services (commercial) rather than general financing (investment), (2) risk to initial investment, (3) giving certain rights to a

> payee (investment), (4) repayment contingent on profit or out of production (investment), (5) a large number of notes or payees (investment), (6) a large dollar amount (investment), (7) fixed time notes (equivocal) rather than demand notes (commercial), and (8) characterization by the parties themselves.

Id. Other federal courts have similarly utilized these factors. *See Great W. Bank & Trust v. Kotz*, 532 F.2d 1252, 1257-58 (9th Cir. 1976); *C.N.S. Enters. v. G. & G. Enters.*, 508 F.2d 1354, 1361-62 (7th Cir.), *cert. denied*, 423 U.S. 825 (1975); *McClure*, 497 F.2d at 493 & n.2. As we implicitly recognized in *Zabriskie*, 507 F.2d at 551-52, and as other courts have explicitly stated, "These criteria are helpful but each case appears to require its own decision based upon its own facts," *C.N.S. Enters.*, 508 F.2d at 1362; *see also Hunssinger v. Rockford Business Credits, Inc.*, 745 F.2d 484, 488 (7th Cir. 1984); *McClure*, 497 F.2d at 493 n.2. Not all factors, therefore, must point in the same direction in order for an instrument to be considered an investment.

Several factors are particularly important in this case. Foremost among them is the fact that RTS and RFC solicited the general public for investments in their passbook savings certificates and thrift certificates. After an extensive review of the cases in this area, the Fifth Circuit concluded that offering notes to a broad class of investors "usually indicated the investment overtones of the underlying transactions." *Id.* at 493-94; *see also Hunssinger*, 745 F.2d at 492 ("broad solicitation of members of the general public" and "sale to them of units of a larger offering are the hallmarks of an investment transaction"); *Zabriskie*, 507 F.2d at 551 n.9 ("large dollar amount" and "large number of notes or payees" cited as factors indicating a security). We agree.

According to the complaint, these instruments were offered and sold in various denominations[6] to the general public and

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6 The complaint specifies the named plaintiffs' purchases of instruments in denominations ranging from approximately $100 to $100,000, with most purchases falling in the $1500 to $10,000 range.

were purchased by more than 10,000 investors. In circumstances similar to this case, the Seventh Circuit rejected an argument by a broker-dealer that the antifraud provisions of the federal securities laws did not apply to instruments which it had offered for sale to the general public. *Sanders v. John Nuveen & Co.*, 463 F.2d 1075, 1079-80 (7th Cir.), *cert. denied*, 409 U.S. 1009 (1972). Nuveen, the broker-dealer, had purchased " 'short term open market' paper" issued by an entity "engaged in the business of making loans." *Id.* at 1079. The paper was offered to the general public and was bought by forty-two purchasers, most of whom invested less than $100,000. *Id.* at 1079 & n.14. When the issuing entity became insolvent, the purchasers brought suit against Nuveen. The Seventh Circuit held in that case that under the "economic reality" of the transaction, "it is reasonably clear that plaintiff and his class purchased the kind of 'security' in regard to which the securities acts were intended to offer protection against fraud, misrepresentation and nondisclosure. . . . We believe Congress intended to protect against fraud the purchasers of securities such as those involved here . . . ." *Id.* at 1079-80 (footnote omitted).

Although no broker was involved in this case, the court's reliance upon the public offering of notes in *Sanders* is persuasive here as well. The note holders in that case were certainly not commercial actors, such as banks, seeking to make commercial loans. They were investors seeking a passive return on their investment.

> When a prospective borrower approaches a bank for a loan and gives his note in consideration for it, the bank has purchased commercial paper. But a person who seeks to invest his money and receives a note in return for it has not purchased commercial paper in the usual sense. He has purchased a security investment.

Id. at 1080, *quoted in Zabriskie*, 507 F.2d at 551; *see also Hunssinger*, 745 F.2d at 492 (notes sold to passive investors held to be securities).

Under the circumstances in this case, the public offering aspect of the transaction indicates that an investment transaction has transpired. The need to effectuate the purpose of the

securities laws in protecting the "public from the sale of worthless securities through misrepresentation" is especially acute. *Gary Plastic*, 756 F.2d at 237. "In an investment situation, the issuer has superior access to and control of information material to the investment decision." *Kotz*, 532 F.2d at 1262 (Wright, J., concurring). The information advantage held by the issuer makes most investors dependent upon the honesty and goodwill of the issuer to disclose accurate, relevant information.

Commercial lenders, such as banks, are often able to overcome this information disadvantage.

> While banks are subjected to risks of misinformation, their ability to verify representations and take supervisory and corrective actions places them in a significantly different posture than the investors sought to be protected through the securities acts.
>
> . . . Rather than relying solely on semi-anonymous and secondhand market information, as do most investors, the commercial bank deals "face-to-face" with the promissor. The bank has a superior bargaining position and can compel wide-ranging disclosures and verification of issues material to its decision on the loan application.

Id. at 1261-62 (Wright, J., concurring).

In contrast, the typical members of the general public responding to a public offering, such as the investors in this case, individually lack the practical ability to obtain such disclosures and verifications to insure a sound investment decision. Furthermore, without the capacity to obtain such information on an ongoing basis after they have committed capital to the enterprise, such investors also effectively lack the ability to monitor the financial condition of the issuing entity or to implement protective or supervisory controls to protect their investment.[7] Such investors must depend upon the honesty and

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7 Although a regulatory agency may intervene on behalf of such investors, the proper focus in making the initial determination whether a transaction is commercial or investment in character is upon the primary actors directly involved in the transaction.

goodwill of the issuing entity. The securities laws provide necessary protection for such investors when those affiliated with the issuing entity breach this trust. *See Matek*, 862 F.2d at 724-25 ("The securities acts protect those without inside access to information about an investment from overreaching or manipulation of their investments by insiders or promoters.").

Closely related to this protection rationale is the fact that here the instruments were issued as a vehicle for raising capital which was apparently used as general financing for RTS and RFC, and which involved the risk of total loss for the investors. This was not a secured lending transaction in which the creditor obtained collateral that would protect his investment in the event of default. Neither does the transaction appear to be a commercial unsecured loan in which the parties contemplated the risk and structured the agreement accordingly. *See, e.g., Kotz*, 532 F.2d at 1259.

The issuer's characterization of the instrument is also an appropriate consideration in determining whether a transaction is investment or commercial in nature. *See Zabriskie*, 507 F.2d at 551 n.9. The record shows that at least some of the offering materials used to induce purchases of instruments issued by RTS and RFC referred to the contributions by investors as "investments," expressly disclaiming that they were "deposits." Furthermore, RFC filed prospectuses with the Oklahoma Securities Commission, characterizing the instruments it issued as "securities."[8] Although the name given is not dispositive, neither is it wholly irrelevant. *Forman*, 421 U.S. at 850. The use of these terms could have lead purchasers "justifiably to assume that the federal securities laws apply." *Id.*

We recognize that not all of the factors cited in *Zabriskie* point toward finding a security in this case. Repayment of the

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8 Instruments offered or sold to the general public on the representation that they are an attractive investment are generally deemed to be securities. As the Supreme Court has emphasized, courts should consider " 'the plan of distribution, and the economic inducements held out to the prospect. In the enforcement of an act such as [the Securities Act] it is not inappropriate that promoters' offerings be judged as being what they were represented to be.' " *SEC v. United Benefit Life Ins. Co.*, 387 U.S. 202, 211 (1967) (quoting *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 352-53 (1943)).

instruments issued by RFC and RTS is not contingent on profit or production as contemplated by the *Zabriskie* factors, except in the broad sense that failure of the institution as a result of long-term unprofitability defeats repayment. This factor, however, is somewhat unreliable because it would disqualify any note with a fixed rate of interest. Such a result would clearly be contrary to the purposes of the Acts. *See Hunssinger*, 745 F.2d at 490-91.

The Supreme Court's statements concerning application of the *Howey* test, which also contains a profits element, underscore the unreliability of this factor. The *Howey* test—"whether the [investment] scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others"—was articulated by the Supreme Court to determine whether a putative security is an "investment contract," one of the general terms in the definitional statute. *SEC v. W.J. Howey Co.*, 328 U.S. 293, 298-99, 301 (1946). Although the Supreme Court has noted in dicta that the *Howey* test "embodies the essential attributes that run through all of the Court's decisions defining a security," *Forman*, 421 U.S. at 852, the Court has subsequently rejected the proposition that the *Howey* test is applicable to all securities:

> [W]e would note that the *Howey* economic reality test was designed to determine whether a particular instrument is an "investment contract," not whether it fits within *any* of the examples listed in the statutory definition of "security." Our cases are consistent with this view. Moreover, applying the *Howey* test to traditional stock and all other types of instruments listed in the statutory definition would make the Acts' enumeration of many types of instruments superfluous.

Landreth, 471 U.S. at 691-92 (footnote and citations omitted) (emphasis in original).

At the time the Court was deciding *Forman*, it had not yet considered whether a debt instrument fell within the definitional statute. *Hunssinger*, 745 F.2d at 491; *Exchange Nat'l Bank v. Touche Ross & Co.*, 544 F.2d 1126, 1136 (2d Cir. 1976). In stating that the *Howey* test " 'embodies the essential

attributes that run through all the Court's decisions defining a security,' " *Hunssinger*, 745 F.2d at 491 (quoting *Forman*, 421 U.S. at 852), the Court had "merely identified a characteristic of its past decisions, all of which involved an unusual instrument not easily placed within the ambit of the other terms enumerated in the definitional sections of the securities acts." *Id.*; *see Landreth*, 471 U.S. at 689 n.4.

The Supreme Court's interpretation of the profits element of the *Howey* test as including either "capital appreciation" or "participation in earnings," *Forman*, 421 U.S. at 852; *see also Hunssinger*, 745 F.2d at 490, also creates significant difficulties when applied to debt instruments because fixed interest payments do not fall within either of these definitions. *Hunssinger*, 745 F.2d at 489-90. Applying the profits element of the *Howey* test to every instrument would frustrate the intent of Congress by making superfluous several terms in the definitional statute, such as "bond," "note," and "debenture," all of which typically involve fixed interest payments. *Id.* at 490-91. "[I]f the term 'profits' as used in [the *Howey*] test were not to encompass fixed interest payments, then a twenty-year corporate bond issued in a public offering would not be a security." *Id.* at 491; *see also Exchange Nat'l Bank*, 544 F.2d at 1136 (*Howey* test of "dubious value" in note context). Furthermore, the Court's decision in *Marine Bank*, which was issued subsequent to *Forman*, indicates that some circumstances exist in which certificates of deposit, which typically involve fixed interest payments, can be securities. *See Marine Bank*, 455 U.S. at 560 n.11.

Thus, the fact that repayment is not strictly contingent on profits is not dispositive in this case. Because we analyze the instruments here as "notes" or "evidences of indebtedness," we need not also determine whether they are "investment contracts" under *Howey*.[9]

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9 We note that the Eighth Circuit has held that demand notes issued by a farmers' cooperative to its members must satisfy the *Howey* test to qualify as securities under the federal securities laws. *Arthur Young & Co. v.*

Similarly, the demand character of the passbook savings certificates is not dispositive. Although there is authority for the proposition that "a demand or short-term note is *almost ipso facto* not a security unless payment is dependent upon the success of a risky enterprise, or the parties contemplate indefinite extension of the note or perhaps conversion to stock," *Kotz*, 532 F.2d at 1257-58 (emphasis added), we refuse to make a talisman of this factor. As discussed above, the maturity of a note does not determine its commercial or investment character. *McClure*, 497 F.2d at 495; *SEC v. Continental Commodities Corp.*, 497 F.2d 516, 524-25 (5th Cir. 1974). We doubt that Congress intended to allow the issuing entity to circumvent the securities laws solely through utilizing a short-term or demand maturity. *See SEC v. American Bd. of Trade, Inc.*, 751 F.2d 529, 539-40 (2d Cir. 1984).

Considering all of the relevant factors, we conclude that the passbook savings certificates and thrift certificates issued by RFC and RTS are investment, rather than commercial, instruments. The "context" of the factual circumstances underlying the issuance of these instruments does not require that they be excepted from the scope of the definitional statutes.

B.

Even if the instruments here potentially qualify as securities because of the factual circumstances underlying the transactions, the context of other federal regulation may still remove these instruments from the federal securities laws. *See Marine Bank*, 455 U.S. at 557-59; *Daniel*, 439 U.S. at 569-70. RFC and RTS have been subject to both federal and state regulation by various banking and regulatory agencies. Thus, we must consider whether the purposes of the federal securities laws have

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Reves, 856 F.2d 52, 54 (8th. Cir. 1988), *petition for cert. filed*, 57 U.S.L.W. 3622 (U.S. Mar. 2, 1989) (No. 88-1480). The Seventh Circuit has recently followed *Reves* by similarly utilizing the *Howey* test. *See Schlifke v. Seafirst Corp.*, 866 F.2d 935, 941-42 (7th Cir. 1989). For the reasons discussed above, we reject this analysis.

been effectuated by the regulatory schemes applicable to RFC and RTS.

In *Marine Bank* the Supreme Court addressed the scope of protection afforded by the securities laws in the context of a regulated environment. The Court considered whether a certificate of deposit issued by a federally regulated bank fell within the scope of the securities laws, ultimately holding that it did not. *Marine Bank*, 455 U.S. at 559. The Court relied upon the policy of providing protection for investors in deciding that question, stating that

> [t]he definition of "security" in the 1934 Act provides that an instrument which seems to fall within the broad sweep of the Act is not to be considered a security if the context otherwise requires. It is *unnecessary* to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of deposit are *abundantly protected* under the federal banking laws.

Id. at 558-59 (emphasis added). In the Court's view, such a bank certificate of deposit differed significantly from other long-term debt obligations because

> [t]his certificate of deposit was issued by a *federally regulated* bank which is *subject to the comprehensive set of regulations* governing the banking industry. Deposits in federally regulated banks are protected by the reserve, reporting, and inspection requirements of the federal banking laws; advertising relating to the interest paid on deposits is also regulated. In addition, deposits are insured by the Federal Deposit Insurance Corporation.

Id. at 558 (emphasis added) (footnotes omitted). The Court stated that "appropriate weight" must be given to "the important fact that the purchaser of a certificate of deposit is *virtually guaranteed payment in full*, whereas the holder of an ordinary longterm debt obligation assumes the risk of the borrower's insolvency." *Id.* (emphasis added).

The Court held that the certificate of deposit issued by the federally regulated bank in that case was not a security because

of the presence of comprehensive regulation of the banking industry that "abundantly protected" the holders of such certificates of deposit. *Id.* at 559. The Court left open the possibility, however, that in some circumstances a certificate of deposit could be a security, which would entitle the holder to the protection of the securities laws.

> It does not follow that a certificate of deposit or business agreement between transacting parties invariably falls outside the definition of a "security" as defined by the federal statutes. Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole.

Id. at 560 n.11;[10] *see also Bradford*, 670 F. Supp. at 933 n.24 (stating that Court's reference to business agreement between transacting parties "could include a passbook type of arrangement").

Likewise, in *Daniel*, the Supreme Court rejected a claim that certain pension plans are securities, 439 U.S. at 559, 566, noting that "the enactment of ERISA . . . put the matter to rest," *id.* at 569. "The existence of this comprehensive legislation governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to noncontributory, compulsory pension plans. Congress believed that it was filling a regulatory void when it enacted ERISA . . . ." *Id.* at 569-70. In addition, the Court noted that in light of ERISA, extension of the federal securities laws into this area serves no general purpose. *Id.* at 570. The Court stated that "[w]hatever benefits employees might derive from the effect of the Securities Acts are now provided in more definite form through ERISA." *Id.*

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10 Although the definition of a security in the 1933 and 1934 Acts was amended after *Marine Bank* to include options on certificates of deposits, the legislative history is explicit that no change in the current law regarding the treatment of certificates of deposit was intended. H. Rep. No. 626, pt. I, 97th Cong., 2d Sess. 10, *reprinted in* 1982 U.S. Code Cong. & Admin. News 2780, 2788.

The crucial factor present in both of these decisions is the "context" of comprehensive *federal* regulation providing sufficient protection to the holders of such instruments to make unnecessary the protection of the federal securities laws. The Supreme Court was careful to note that comprehensive federal regulation was the basis of both *Marine Bank* and *Daniel. See Marine Bank*, 455 U.S. at 558 & n.7. We interpret *Marine Bank* in light of the supremacy clause to exclude the possibility that the "context" of state regulation is sufficient to displace the federal securities laws. A more expansive reading of the "context" clause would permit states to create their own exemptions to federal securities law coverage, which Congress clearly did not intend.

When Congress has created a comprehensive system of regulation applicable to securities, and important remedies based upon that system exist under federal law, the normal operation of the supremacy clause does not permit state regulation to preempt federal law. *See SEC v. National Sec., Inc.*, 393 U.S. 453, 463 (1969). Unless Congress specifically acts to reserve the regulation of securities to the states, the "paramount federal interest in protecting shareholders," *id.*, under the securities laws mandates that federal remedies be available for investors. Otherwise, we would "emasculate the securities laws by forbidding remedies which might prove to be essential." *Id.*

Congress clearly has the power to create an exemption from the securities laws or to reserve some regulatory powers exclusively to the states. *See, e.g.*, 15 U.S.C. §§ 77c, 77d (exempting certain instruments or transactions); *id.* § 77r-1 (permitting state to preempt application of section 77r-1(a) by adopting more restrictive statute). As a general rule, however, Congress has provided for concurrent regulation of securities by both the federal government and the states. *Id.* §§ 77r, 78bb(a).

The Supreme Court's discussion in *SEC v. Variable Annuity Life Insurance Co. of America*, 359 U.S. 65 (1959), is instructive on Congress' intent in permitting concurrent securities regulation. At issue was whether "variable annuity" contracts, which had developed after Congress passed the exempting statute, were within the scope of the statutory exemption for any "insurance policy" or "annuity contract" that "was subject to

the supervision of the state 'insurance commissioner, bank commissioner, or any agency or officer performing like functions.' " *Id.* at 73-74 (Brennan, J., concurring) (quoting 15 U.S.C. § 77c(a)(8)). The Court held that the meaning of the terms of the federal statute was a federal question. *Id.* at 69. The state regulators' decisions regarding the definition of insurance or of annuity were "not decisive." *Id.* Justice Brennan's concurring opinion explains why this is so:

> [H]owever adequately State Securities Commissioners might regulate an investment, it was not for that reason to be freed from federal regulation. Concurrent regulation, then, was contemplated by the Acts as a quite generally prevailing matter. [It is not] rational to assume that Congress thought that *any* business whatsoever regulated by a specific class of officials, [such as] the State Insurance Commissioners, would be for that reason so perfectly conducted and regulated that all the protections of the Federal Acts would be unnecessary. This approach of personally selective deference to the state administrators is hardly to be attributed to Congress.

Id. at 75 (Brennan, J., concurring) (emphasis in original).

Accordingly, we find nothing in the securities acts to indicate that Congress intended the states to displace the protections of the federal securities laws in this case. Congress has not exercised its power to suspend "the normal operations of the Supremacy Clause" by permitting the states to have paramount regulatory power. *See National Sec.*, 393 U.S. at 463. On the contrary, the statutes direct that "state regulation may co-exist with that offered under the federal securities laws," *id.* at 461 (citing 15 U.S.C. §§ 77r, 78bb(a)), and that nothing in the statutes "shall affect the jurisdiction of the securities commission (or any agency or officer performing like functions) of any State over any security or any person *insofar as it does not conflict* with the provisions [of the federal securities laws]," 15 U.S.C. § 78bb(a) (emphasis added). The displacement of federal law through state regulation is therefore fundamentally inconsistent with the coexistence directed by Congress. Without specific direction to the contrary from Congress, the federal

courts do not have the power to trump the paramount federal interest in protecting investors by creating additional exemptions to securities law coverage through the "context" of state regulation.[11] *See National Sec.*, 393 U.S. at 468.

The interpretation of the interrelationship among the securities acts and other federal regulatory schemes promulgated by Congress, however, is clearly within the power of the federal courts, as the Supreme Court demonstrated in *Marine Bank*. We must therefore examine whether federal banking regulation applicable to RFC, RTS, and RBI is sufficient to satisfy the standard set forth in *Marine Bank*—whether the context of federal regulation abundantly protects investors, thereby making the protections of the federal securities laws unnecessary. *See Marine Bank*, 455 U.S. at 558-59.

As discussed above, an important purpose of the federal securities laws is to protect investors "from the sale of worthless securities through misrepresentation." *Gary Plastic*, 756

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11 The Ninth Circuit has held that a certificate of deposit issued by a Mexican bank was not a security. *Wolf v. Banco Nacional de Mexico, S.A.*, 739 F.2d 1458, 1463-64 (9th Cir. 1984), *cert. denied*, 469 U.S. 1108 (1985); *accord West v. Multibanco Comermex, S.A.*, 807 F.2d 820, 827 (9th Cir.), *cert. denied*, 482 U.S. 906 (1987). In *Wolf* "it was conceded that the *Mexican government's regulation* of [the bank] provides its certificate holders the *same degree of protection* against insolvency as does the federal system in this country." *Wolf*, 739 F.2d at 1463 (emphasis added). Although the decision in *Wolf* denied recourse to investors under the federal securities laws based on regulation by the Mexican government, its result is distinguishable on the ground that investors in that case essentially had foreign exchange losses, and not losses caused by insolvency of the issuing bank. Each of the holders of Mexican certificates of deposit received the same amount of pesos as were deposited, and the losses were the result of the Mexican government's devaluation of the peso. To the extent that *Wolf* interprets *Marine Bank* to allow regulation by an entity other than the federal government to displace the protection of the federal securities laws, we disagree under the supremacy rationale stated above.

The Fourth Circuit has similarly held that certificates of deposit issued by state-chartered savings and loans were not securities because of the State of Maryland's comprehensive regulatory scheme governing the issuing entities. *Tafflin v. Levitt*, 865 F.2d 595, 598-99 (4th Cir. 1989), *cert. granted on unrelated issue*, 1989 U.S. LEXIS 2658 (May 30, 1989) (No. 88-1650). We similarly disagree with this analysis based upon the supremacy rationale discussed above.

F.2d at 237. Although information disclosure provisions contribute significantly toward providing this protection, *see SEC v. Ralston Purina Co.*, 346 U.S. 119, 124 (1953), private remedies have also grown to play an important part of the protections afforded by federal law, *see J.I. Case Co. v. Borak*, 377 U.S. 426, 432 (1964); *see also Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 737 (1975). We interpret *Marine Bank* to permit other federal regulation to displace the federal securities laws only through fulfilling the disclosure and remedial purposes of the securities laws by alternate means.

In the context of federal regulation of banks, the regulators may satisfy the standard required by *Marine Bank* through exercising certain powers on behalf of investors. In order to give substance to the information disclosure purposes of the securities laws, the regulators must possess investigative powers to verify information proffered by the issuer, to compel disclosure of information that is material to the initial investment decision, and to monitor the ongoing financial condition of the regulated entity. *See Marine Bank*, 455 U.S. at 558 & n.8 (noting reporting and inspection requirements and advertising regulations applicable to banks under federal law). Further, substantive limitations upon the lending and investment activities of banks also protect depositors. *See id.* (noting reserve requirements). Therefore, in lieu of full disclosure to investors of relevant, accurate information upon which to base an investment decision, investors are protected by another entity that acts on their behalf to monitor the issuing entity and to take corrective actions to protect their investments. The dependence upon this monitoring function is especially appropriate in an industry such as banking due to the confidential, nonpublic nature of many of the lending and investment activities of financial institutions.

The statutory framework of the federal securities laws also provides meaningful remedies for investors when the antifraud provisions of the laws have been violated. For example, section 10(b) of the 1934 Act, 15 U.S.C. § 78j(b), and SEC rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1988), have been interpreted to authorize private damage actions for an investor to recover from any person who makes untrue state-

ments of material facts, or otherwise engages in any act to defraud in connection with the purchase or sale of a security. *See Gilbert v. Nixon*, 429 F.2d 348, 355 (10th Cir. 1970). *See generally* T. Hazen, *The Law of Securities Regulation* § 13.2 (1985). Thus, the purposes of the federal securities acts cannot be effectively carried out unless the alternate federal regulation provides for a meaningful remedy to investors. In *Marine Bank* the Supreme Court implicitly recognized the importance of meaningful remedies when it found "abundant protection" in part because of the "virtual guarantee of repayment in full." *Marine Bank*, 455 U.S. at 558-59. The presence of federal deposit insurance that had historically fully repaid holders of the type of instruments at issue in *Marine Bank* was evidence of a remedy analogous to that provided to individual investors under the federal securities laws. *See id.*

With this background in mind, we turn to analyze the regulatory structure applicable in this case. At the outset, we note that this analysis must be divided into two time periods—before and after RBI divested its bank subsidiary. During the time that RBI was a bank holding company, RBI and all of its subsidiaries, including nonbank subsidiaries such as RTS and RFC, were subject to some degree of federal regulation. After RBI divested RBT (its bank subsidiary), RBI was no longer a bank holding company because it held only nonbank subsidiaries. Therefore, RBI and its subsidiaries were no longer *federally* regulated under the Bank Holding Company Act of 1956 (BHCA), 12 U.S.C. §§ 1841-1850, 1971-1978.[12] Only state regulation by the Oklahoma Banking Department and the Oklahoma Securities Commission remained in effect.

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12 The BHCA covers "any company which has control over any bank or over any company that is or becomes a bank holding company by virtue of [the BHCA]." 12 U.S.C. § 1841(a). After the divestiture of RBT, neither RBI nor its subsidiaries qualified as banks as defined in 12 U.S.C. § 1841(c). RTS was specifically held not to be a bank in *In re Republic Trust & Savings Co.*, 59 Bankr. 606, 612 (Bankr. N.D. Okla. 1986), *appeal denied*, *In re Republic Financial Corp.*, 77 Bankr. 282 (N.D. Okla. 1987). After RBI divested its bank subsidiary, none of the remaining entities were members of the FDIC or the Federal Reserve System, and therefore they were not subject to federal regulation.

Based upon our holding that only federal regulation may be considered in the "context" analysis, no amount of state regulation is sufficient to satisfy the *Marine Bank* standard. Any instruments issued after divestiture of the bank, therefore, are not excluded from the definition of a security by virtue of the "context" of regulation. The district court erred in considering state regulation in its "context" analysis, and we therefore reverse the district court's holding that state regulation of RTS through the Oklahoma Banking Department satisfied *Marine Bank* and that the instruments issued by RTS were not securities on that account. Similarly, although the district court improperly considered state regulation of RTS by the Oklahoma Securities Commission, we nevertheless affirm the result that such regulation was insufficient to satisfy *Marine Bank*.

With regard to the instruments issued prior to divestiture, the district court considered both federal and state regulation of RFC, RBI, and RTS. Although the district court erred in considering the state regulation, we affirm the district court's holding that the federal regulation applicable to the issuing entities in this case was insufficient to satisfy *Marine Bank*.

Prior to divesting RBT, RBI was a bank holding company, and its subsidiaries RFC and RTS were therefore subject to federal regulation under the BHCA. The FRB is the regulatory body charged with administering the BHCA and the related regulations. The primary purpose of the FRB's administration of the BHCA, however, is to protect the stability and financial viability of subsidiary banks held by the holding companies. The FRB has stated its policy in regulating the corporate practices of bank holding companies:

> (a) *Bank holding company policy and operations.* (1) A bank holding company shall serve as a source of financial and managerial strength to its subsidiary banks and shall not con[d]uct its operations in an unsafe or unsound manner.
>
> (2) Whenever the Board believes an activity of a bank holding company or control of a nonbank subsidiary (other than a nonbank subsidiary of a bank) constitutes a serious risk to the financial safety, soundness, or stability

> of a subsidiary bank of the bank holding company and is inconsistent with sound banking principles or the purposes of the BHC Act or the Financial Institutions Supervisory Act of 1966, as amended (12 U.S.C. 1818(b) *et seq.*), the Board may require the bank holding company to terminate the activity or to terminate control of the subsidiary, as provided in section 5(e) of the BHC Act.

12 C.F.R. § 225.4(a) (1988). Thus, if the holding company or its nonbank subsidiaries engage in activities that threaten the financial stability of the bank, the FRB has the power under the BHCA to order divestiture of nonbank entities, thereby protecting the bank's depositors.

The district court found that such federal regulation here did not "abundantly protect" the investors because it was aimed at protecting the *bank's depositors*, not investors in the bank holding company and the nonbank subsidiaries. We agree.

The protection afforded the investors in RTS and RFC as a result of federal regulation of RBI's nonbank subsidiaries was merely incidental to the protection of the bank's depositors. Although the investors in the nonbank entities benefited from the regulatory protection of the bank's depositors, their protection was dependent upon the coincidence of their interests with those of the bank's depositors. The nonbank investors' protection could disappear at any time, as demonstrated by the FRB's directive to RBI to divest the bank, leaving them exposed to substantial risk of loss, without a substantive remedy other than a claim in the assets of the insolvent company. This result is in direct contrast to the securities laws, which would provide continuous protection for such investors, and which provide potential remedies through the antifraud provisions. The investors in the nonbank subsidiaries also did not enjoy access to the important remedial benefit of federal deposit insurance, which *Marine Bank* determined to be an important part of the "virtual guarantee" necessary to displace the protection of the securities laws.

The indirect and potentially nonexistent protection provided by federal regulation in this case does not approach the level of "abundant protection" mandated by *Marine Bank*. Therefore,

the "context" of federal regulation of RBI and its nonbank subsidiaries, RFC and RTS, prior to RBI's divestiture of its bank subsidiary, was insufficient to exclude from the definition of a security any instruments issued by RFC and RTS prior to divestiture.

C.

In sum, "[u]nlike *Marine Bank*, federal securities fraud protection in this case is not a double-coating." *Gary Plastic*, 756 F.2d at 241. Rather, "absent the securities laws," the plaintiffs here did not have the abundant "protection against fraud and misrepresentation by the defendants in the marketplace" that is required by *Marine Bank*. *Id.* After considering the context of the underlying transactions, including the context of federal regulation, we conclude that the instruments issued by RTS and RFC are securities for the purposes of the federal securities laws.

III.

With regard to the note issued by RBI, we conclude that certain material facts necessary to decide whether it falls within the scope of the definitional statute are not established in the record. The only evidence submitted by the plaintiff on this issue is the note itself. The face of the note does not convey the context under which the note was issued, including whether the parties negotiated the terms specifically for this transaction, as opposed to an offer at fixed terms to the general public, and whether Cal Acree, the putative investor, was in the business of commercial lending. *Cf. Mace Neufeld Prods., Inc. v. Orion Pictures Corp.*, 860 F.2d 944, 946 (9th Cir. 1988) ("single unique agreement, 'negotiated one-on-one' between two parties," and not designed to be publicly offered or traded not "a security" (quoting *Marine Bank*, 455 U.S. at 559)). Therefore, we reverse the summary judgment award in favor of the plaintiff as to the RBI note and remand for consideration of the context of the underlying transaction consistent with this opinion.

IV.

We reverse the summary judgment in favor of the defendants as to the RTS instruments and remand to enter summary judgment in favor of the plaintiffs. We affirm the grant of summary judgment for the plaintiffs as to the RFC instruments. We reverse the summary judgment in favor of the plaintiff as to the RBI note and remand for further consideration.

AFFIRMED IN PART, REVERSED IN PART, AND REMANDED.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

No. 84-C-814-EU

FILED March 3, 1987

W. DAVID HOLLOWAY, M.D., *et al.*,

Plaintiffs,

v.

PEAT, MARWICK, MITCHELL & CO., a partnership, *et al.*,

Defendants.

AMENDED ORDER AND JUDGMENT

Based on the Orders of December 30, 1986 and February 4, 1987, and the Journal Entry of Partial Summary Judgment (the "Prior Orders"), wherein this Court granted partial summary judgment to certain Plaintiffs on the issue of the subject matter jurisdiction of the Court over claims involving the RBI and RFC instruments and granted summary judgment to Defendants on the issue of the subject matter jurisdiction of the Court over claims involving the RTS instruments, this Court is of the opinion, and finds, (i) there is no just reason for delay and that final judgment pursuant to F.R.Civ.P. 54 (b) should be entered as to the claims of Plaintiffs who hold instruments of RTS; and (ii) an order of certification under 28 U.S.C. § 1292(b), should be entered as to the issue of subject matter jurisdiction as to the claims of Plaintiffs who hold instruments of RFC and RBI.

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that, pursuant to Rule 54(b), F.R.Civ.P., final judgment on the issue of subject matter jurisdiction is hereby entered in favor of Defendants and against Plaintiffs who hold instruments of RTS, and all claims with regard to RTS instruments, of those

Plaintiffs are hereby dismissed and that there is no just reason for delay in entering final judgment.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that partial summary judgment on the issue of subject matter jurisdiction is hereby entered against Defendants and in favor of Plaintiffs who hold instruments of RBI and RFC.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this Order, and the Prior Orders involve a controlling issue of law as to which there is substantial ground for difference of opinion, and that an immediate appeal from these Orders may materially advance the ultimate termination of this litigation.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that the controlling issue of law, *i.e.*, whether the instruments of RBI and RFC are securities under the federal securities laws so as to invoke this Court's subject matter jurisdiction over a federal question, is hereby certified for interlocutory appeal pursuant to 28 U.S.C. § 1292(b), and the Prior Orders are amended to conform herewith.

IT IS FURTHER ORDERED, ADJUDGED AND DECREED that this action is hereby stayed pending resolution of the certified question, if the Tenth Circuit Court of Appeals grants the petition for permission to appeal certified question. The parties may, however, apply for a lift of the stay upon a showing that testimony of a witness may otherwise be lost because of illness, infirmity or absence from the United States.

DATED this 26th day of February, 1987.

/s/ LUTHER B. EUBANKS

Luther B. Eubanks
Senior United States District Judge

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

No. 84-C-814-EU

FILED February 6, 1987

W. DAVID HOLLOWAY, *et al.*,

Plaintiffs,

v.

PEAT, MARWICK, MITCHELL & CO., *et al.*,

Defendants.

ORDER

Defendants "request this court to enter a clarifying order stating whether, insofar as the instruments issued by RFC and RBI are concerned, the Economic Realities test was considered and applied in its Order or was held to be inapplicable, and, if inapplicable, the reasons therefor." Defendants' Brief in Support of Motion for Clarification of Order of December 30, 1986, at p. 3.

The court considered the commercial/investment test (called the Economic Realities test by defendants) in its Order of September 23, 1985, and directed the parties to conduct discovery on the "regulatory structure" issue. Implicit in that Order is the idea that if these debt instruments are not securities under the commercial/investment test, the case would have been dismissed at that point.

As stated in the Order of December 30, 1986, the facts are not in dispute. The instruments at issue are fixed-rate, short-term notes and "Thrift Certificates." "[T]he test is what character the instrument is given in commerce by the terms of the offer, the plan of distribution, and the economic inducements held out to the prospect. [citations omitted.] The broad statutory

definition is preceded, however, by the statement that the terms mentioned are not to be considered securities if 'the context otherwise requires. . . .' Moreover, we are satisfied that Congress, in enacting the securities laws, did not intend to provide a broad federal remedy for all fraud." *Marine Bank v. Weaver*, 455 U.S. 551, 556 (1982).

For purposes of clarification, the court finds that the instruments sued on here are securities given their context. These instruments were sold through solicitation of members of the general public. They had the characteristics of an investment rather than a commercial loan transaction because purchasers were individuals seeking a passive source of income. These instruments were very similar to certificates of deposit except they were not issued by a bank as discussed in the Order of December 30, 1986. The investors assumed the risk of the issuer's insolvency.

Considering the context of these instruments, the court finds these are investment securities rather than commercial promisary notes. *See Banowitz v. State Exchange Bank*, 600 F. Supp. 1466 (N.D. Ill. E.D. 1985).

The Clerk of Court is instructed to mail copies hereof to all counsel/parties of record.

ORDERED this 4th day of February, 1987.

/s/ LUTHER B. EUBANKS

Luther B. Eubanks
United States Senior District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

No. 84-C-814-EU

FILED January 2, 1987

W. DAVID HOLLOWAY, *et al.*,

Plaintiffs,

v.

PEAT, MARWICK, MITCHELL & CO., *et al.*,

Defendants.

ORDER

The court has for consideration the Defendants' Motion for Summary Judgment and Plaintiffs' Motion for Partial Summary Judgment. In an order filed September 23, 1985, the court converted defendants' motions to dismiss to motions for summary judgment and narrowed the issue for consideration to whether the regulatory structure surrounding Republic Trust and Savings ("RTS"), Republic Financial Corporation ("RFC") and the second Republic Bancorporation, Inc. ("RBI") was sufficient to preclude the application of securities laws to the instruments issued by those companies. Accordingly, the parties have conducted extensive discovery and provided supplemental briefs to assist the court with the initial question in this case of whether the instruments sued upon are securities.

These instruments do not fall into the statutory definitions found in 15 U.S.C. Section 77b(1) and 15 U.S.C. Section 78c(a)(10). In its order of September 23, 1985, this court recognized other tests [e.g. from *Securities and Exchange Comm'n v. W. J. Howey Co.*, 328 U.S. 293 (1946)] used to define a "security" but directed the parties to focus on the regulatory system

surrounding RBI, RTS & RFC. This approach is in accordance with *Marine Bank v. Weaver*, 455 U.S. 551 (1982). There, the Supreme Court held that a certificate of deposit issued by a federally regulated bank which is subject to the comprehensive regulations governing the banking industry is not a security. "It is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws." *Id.* at 559.

The Ninth Circuit and the Fifth Circuit have applied the same principle to certificates of deposit issued by Mexican banks in *Wolf v. Banco Nacional de Mexico, S.A.*, 739 F.2d 1458 (9th Cir. 1984), *cert. denied*, 469 U.S. 1108 (1985) and *Callejo v. Bancomer, S.A.*, 764 F.2d 1101 (5th Cir. 1985). Those circuit courts of appeal held that the *Marine Bank* opinion was not restricted to regulation by federal banking authorities and that it could be applied to regulation by Mexican authorities:

> We think that the Court found it significant that the issuing bank was regulated, and regulated adequately, not that it was the federal government that regulated it. Therefore, it was because repayment in full was "virtually guaranteed" and the certificate holders were "abundantly protected" that the certificates of deposit were outside the definition of "security" and the protection of the federal securities acts.

Wolf v. Banco Nacional de Mexico, S.A., 739 F.2d 1458, 1462 (9th Cir. 1984).

FDIC insurance, or the lack thereof, is not the critical factor in determining the abundance of protection. The court in *Brockton Savings Bank v. Peat, Marwick, Mitchell & Co.*, 577 F. Supp. 1281 (D. Mass. 1983) stated, "The *Weaver* Court's reference to 'payment in full' was not to the insurance coverage but rather to the historical fact of FDIC reimbursement. . . ." *Id.* at 1285.

Mindful of the decisions in *Weaver, Wolf, Callejo*, and *Brockton*, this court addresses the extent of regulation of RBI, RTS and RFC in order to determine if these investors were abundantly protected at the time they purchased the instru-

ments at issue. A brief description of the facts is required. The first Republic Bancorporation, Inc. was a bank holding company with four subsidiaries, namely, Sunbelt Bank and Trust (formerly, Republic Bank and Trust), 1700 Sheridan Corporation, Republic Trust and Savings, and Republic Financial Corporation. In June, 1984, because of the dire financial condition of the non-banking subsidiaries, the Federal Reserve required the divestiture of Sunbelt Bank and Trust pursuant to the Bank Holding Company Act ("BHCA"), 12 U.S.C. Section 1841 *et seq.* and Section 225.4(a) of the Federal Reserve Board's Regulation Y, 12 C.F.R. Section 225.4(a). On June 29, 1984, the divestiture transaction was completed. Thereafter, RBI was the parent of only RFC and RTS. Sunbelt Bank and Trust and 1700 Sheridan Corporation were subsidiaries of a new corporation, Sunbelt Bancorporation, Inc. Because RBI was not a bank holding company, the Federal Reserve had no regulatory power over it. Plaintiffs are suing on certificates of deposit (called "thrift certificates") and passbook savings accounts purchased issued by RTS and RFC and promissory notes issued by RBI.

The Board of Governors of the Federal Reserve System ("FRB") and the Federal Reserve District Banks administer and enforce the provisions of the BHCA and related FRB regulations and practices. The FRB inspects bank holding companies and their non-bank subsidiaries; it has various enforcement powers, including the power to order activities of the holding company or its non-bank subsidiaries terminated. 12 U.S.C. Section 1844(c). The purpose of the FRB regulation is to preserve the financial stability of the bank. If the holding company or its non-bank subsidiaries engage in activites which endanger the financial soundness of the bank, the FRB's ultimate remedy is to order the divestiture by the bank; such was the situation and the resulting remedy for RBI. This court finds that although the FRB regulated RBI, RTS and RFC, that regulation alone did not "abundantly protect" the purchasers of those companies' debt instruments because it was aimed at protecting the bank depositors, not parties situated as plaintiffs are here.

In *Weaver*, *Wolf*, *Callejo* and *Brockton*, the plaintiffs had purchased certificates of deposit in banks. The courts in those

cases did not want to create an overlap of banking and securities regulations. This court believes no overlap is created if the debt instruments issued by the holding company and its non-bank subsidiaries are deemed securities and thus regulated by the SEC. However, the court's inquiry into the regulation of RBI, RTS and RFC does not stop with federal banking laws; it must also look to state regulation of those companies.

While the FRB treated RBI, RTS and RFC similarly, the state's regulation of them varied. RFC submitted prospectuses for its debt instruments, which are the basis of this litigation, to the Oklahoma Securities Commission ("OSC") and referred to them as securities. The OSC had the power to and did inspect the financial records of RFC. The OSC's enforcement powers included the ability to prohibit RFC from offering and/or selling its securities without adequate disclosure (by refusing to approve the prospectus under 71 O.S. Section 402) and to enjoin acts constituting a violation of the Oklahoma securities laws. 71 O.S. 406.[1] The OSC's regulation was clearly designed to protect the purchasers of RFC's debt instruments from purchasing securities without the benefit of full disclosure by the issuer.

Plaintiffs argue the OSC regulation was not designed to protect purchasers from RFC's insolvency. The *Weaver* "insolvency protection" test is an important one. As the Supreme Court stated, "The Court of Appeals failed to give appropriate weight to the important fact that the purchaser of a certificate of deposit is virtually guaranteed payment in full, whereas the holder of an ordinary long-term debt obligation assumes the risk of the borrower's insolvency." 455 U.S. 551, 558.[2] In *Wolf*, the Ninth Circuit wrote:

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1 Both Sections 402 and 406 of Title 71 of the Oklahoma Statutes have been amended since the time RFC issued the debt instruments sued upon here.

2 The court notes the Supreme Court in *Weaver* emphasized the fact that nearly all depositors in failed banks had received payment in full, including amounts greater than the FDIC insurance limit; the *Weaver* opinion was handed down four months prior to the failure of Penn Square Bank. In all likelihood the FDIC's statistics on payment to uninsured depositors have changed since that time.

> Our decision, therefore, is compelled by the reasoning of Weaver that when a bank is sufficiently well regulated that there is virtually no risk that insolvency will prevent it from repaying the holder of one of its certificates of deposit in full, the certificate is not a security for purposes of the federal securities laws.

Wolf v. Banco Nacional de Mexico, S.A., 739 F.2d 1458, 1463 (9th Cir. 1984). This court finds that because the OSC's regulation of RFC was designed to provide adequate disclosure to purchasers and not to protect them from the risk of insolvency, the regulation did not measure up to the abundant protection required by *Weaver*.

RTS was a state chartered trust company subject to regulation by the Oklahoma State Banking Department. One of the purposes of the Banking Department's regulatory power over trust companies is to protect people who deposit funds in them, according to Wayne Osborn, Oklahoma Deputy Banking Commissioner. Peat Marwick has provided voluminous materials to substantiate the fact the Oklahoma State Banking Department examined RTS. This court is satisfied by the evidence presented that RTS was examined by the Oklahoma Banking Department in a manner very similar to the examination of banks and that the regulation was designed to protect purchasers of thrift certificates and passbook savings accounts from insolvency of RTS. Accordingly, the plaintiffs suing on instruments issued by RTS were abundantly protected by the Oklahoma Banking Department's regulation. No amount of regulation can prevent insolvency, but at least the regulation must be designed to try to prevent insolvency; such was the situation for RTS.

Apparently, no state agency had authority to or did regulate RBI. Therefore, the purchasers of RBI notes were not abundantly protected by a comprehensive regulatory structure.

In summary, there is no genuine issue as to any material fact; the regulatory structure issue is purely a matter of law. After studying the pertinent cases, the briefs and the accompanying documentary evidence and hearing the oral arguments of counsel, the court concludes on the regulatory structure issue, the purchasers of RBI notes and RFC thrift certificates and pass-

book savings accounts were not abundantly protected as is required by *Marine Bank v. Weaver*; purchasers of RTS thrift certificates and passbook savings accounts were abundantly protected. Accordingly, the defendants' motion for summary judgment is granted with respect to RTS instruments and denied as to RBI's and RFC's instruments; plaintiffs' motion for partial summary judgment is granted as to RBI's and RFC's instruments and denied as to RTS's. Counsel will promptly settle decree.

The Clerk of Court is instructed to mail copies hereof to all counsel/parties of record.

ORDERED this 30th day of December, 1986.

/s/ LUTHER B. EUBANKS

Luther B. Eubanks

Senior United States District Judge

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF OKLAHOMA

No. 84-C-814-EU

FILED September 23, 1985

W. DAVID HOLLOWAY, M.D., *et al.*,

Plaintiffs,

v.

PEAT, MARWICK, MITCHELL & CO., a partnership, *et al.*,

Defendants.

ORDER

The Court has for consideration the Motion of Defendants to Dismiss pursuant to Fed.R.Civ.P. 12(b)(1) and (6). Some of the Defendants' motions also seek, in the alternative, summary judgment pursuant to Rule 56(b).

In their Amended Complaint Plaintiffs seek damages under the Securities Acts of 1933 and 1934, and for pendent relief based on common law fraud. Plaintiffs allege that they "are all depositors and holders of certificates, notes and other evidences of indebtedness of Republic Trust & Savings [RTS], an Oklahoma Trust, Republic Financial Corporation [RFC], an Oklahoma corporation and the second Republic Bancorporation, Inc. [RBI], an Oklahoma corporation"; that Plaintiffs' class action is brought "on behalf of themselves and all depositors and holders of [said] certificates, notes and other evidences of indebtedness"; that "[t]he named Defendants consist of the auditor, officers and members of the Board of Directors of the [bankrupt] Republic Companies and some of the non-bankrupt

Republic Companies";[1] that "Defendants have committed the wrongful acts complained of in the Northern District of Oklahoma, specifically in the City of Tulsa"; that each Defendant "is sued individually and as a co-conspirator and the liability of each arises from the fact that each has either engaged or is engaging in all or part of the unlawful acts as charged."

Plaintiffs further allege that RFC, RTS and RBI "were engaged in the offering and sale of securities to the public by the offering of 'six month money market thrift certificates', 'negotiable rate term thrift certificates', 'savings trust certificates', 'savings plans', promissory notes, savings accounts and were receiving deposits of money, forming joint funds for the purpose of making loans, and issuing forms of evidence of indebtedness which constituted the offering and sale of security as defined and interpreted by 15 U.S.C.S. § 77(b) and 15 U.S.C.S. § 78(c)"; that "[t]he securities offered and sold by [RFC, RTS and RBI] were not registered with the Securities and Exchange Commission as required by Section 5 of the Securities Act (15 U.S.C. § 77e(c)) and, therefore, were offered and sold by Defendants in violation of the Securities Acts"; that "Wesley R. McKinney [McKinney] and each of his Republic Companies, boards of directors, officers, employees and accountants, participated in a device, scheme and artifice to defraud and obtain money and property by means of untrue statements of material facts and omissions to state material facts"; that "said parties did engage in transactions, practices and courses of business which operated and would operate as a fraud or deceit upon the Plaintiffs, in the offering and sale of securities by the use of various means, and by the use of instruments of transportation and communication in interstate commerce, and by the use of the mails, both directly and indirectly"; that such communications included publications in the Tulsa World, Tulsa Tribune

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1 RTS, RFC and RBI are sometimes referred to in the Amended Complaint as "bankrupt Republic Companies." The "non-bankrupt Republic Companies" are the Defendants Sunbelt Bank & Trust Company, formerly Republic Bank & Trust Co., a State Bank Association, and Republic Bancorporation, Inc., an Oklahoma corporation a/k/a Sunbelt Bancorporation, Inc.

and The Daily Oklahoma, and long distance intra and interstate telephone communications.

With respect to the Defendant, Peat, Marwick Mitchell & Co., Plaintiffs allege that it was employed by McKinney, individually, and as Chairman of the Board of Directors, Chief Executive Officer and controlling stockholder of the various Republic Companies during the year of 1982, "for the purpose of performing accounting and auditing services on behalf of [McKinney] and his Republic Companies"; that Peat, Marwick, Mitchell & Co. "made public said contract of employment with the notification to the Federal Reserve Board, the Federal Deposit Insurance Corporation, Oklahoma Securities Commission and the Oklahoma Banking Commission"; that it knew the Republic Companies were engaged in the offering and sale of the Securities described above to the public, and knew that the Republic Companies "were receiving deposits of money, forming joint funds for the purpose of making loans, and issuing forms of evidence of indebtedness"; that in accepting said employment, "Peat, Marwick, Mitchell & Co., accepted the applicable common law, and federal statutory duties, . . . dealing with the auditing of bank holding companies"; that it "owed a duty not only to [McKinney] and his Republic Companies, but also to each and every depositor, certificate and note holder, and holder of evidence of indebtedness of said Republic Companies."

Plaintiffs further allege that on the 27th day of January, 1984, Peat, Marwick, Mitchell & Co. "issued an unqualified audit report letter" with respect to each of the Republic Companies, except the second Republic Bancorporation, Inc., attaching to the letters "balance sheets, statements of income, statements of changes in shareholders' equity, statements of changes in financial position with accompanying notes to financial statement"; that the letters stated, *inter alia*, that "[i]n [its] opinion, the financial statements . . . present fairly the financial position of" each of the Republic Companies "at December 31, 1983 and 1982 and the results of [the companies] operations and the changes in [the companies] financial position for the years then ended, in conformity with generally accepted accounting principals applied on a consistent basis";

that the audit report letters of January 27, 1984 "continued in full force and effect until August 24, 1984, at which time the defendant, Peat, Marwick, Mitchell & Co. prepared letters to the Boards of Directors of the Republic Companies, the Federal Reserve Bank, the Oklahoma State Banking Department and the Oklahoma Securities Commission which stated:

> 'Accordingly, we advise you that our auditor's reports dated January 27, 1984, on the aforementioned financial statements should no longer be relied upon and such reports should not be associated with the financial statements referred to therein. Further, we advise you that we withdraw our consent dated May 25, 1984 to the inclusion of our auditor's report in the prospectus of Republic Financial Corporation dated March 31, 1984. We advise you to notify all persons who are known to be relying on or who are likely to rely on such financial statements and our auditor's reports thereon that such financial statements and reports should no longer be relied upon.' "

Plaintiffs further allege that Peat, Marwick, Mitchell & Co. "did not notify, or attempt to notify, from the 27th day of January, 1984 to the 24th day of August, 1984, or thereafter, . . . any of the holders of securities of said Republic Companies of the true and correct financial condition of said Republic Companies"; that it "had a duty to notify and its failure to do so constituted a concealment of the true facts"; that "such concealment was done with the conscious intent to aid and abet the bankrupt Republic Companies in [their] fraud and violation of the Securities Laws of the United States"; that on September 24, 1984 the bankrupt Republic Companies closed their doors to the Plaintiffs and refused to permit withdrawal of funds from the bankrupt companies.

Plaintiffs further allege that the wording of the August 24, 1984 audit report letters "indicate: 1. that the holders of the securities of the Republic Companies were relying upon PEAT, MARWICK, MITCHELL & CO.'S . . . auditors' reports; and 2. that under the applicable auditing standards, that the facts resulting in the withdrawal of said auditors' reports existed on or before December 31, 1983." Plaintiffs further allege that

Peat, Marwick, Mitchell & Co. breached statutory and common law duties by failing to "follow generally accepted auditing standards in its audits of the Republic Companies . . . penetrate into the internal affairs of each of the Republic Companies to determine their true and correct financial condition . . . identify and promptly report insider and related party loans of the Republic Companies . . . unauthorized cash and security removals from the Republic Companies . . . improperly valued assets of the Republic Companies . . . the insolvent condition of each of the Republic Companies as soon as it was discovered . . . non-performing and delinquent loans of the Republic Companies . . . [and] the deficiencies of the internal control systems of each of the Republic Companies. Plaintiffs further allege that Peat, Marwick, Mitchell & Co. failed to "make a truly independent audit of the assets and liabilities of each of the Republic Companies," and failed to "use adequately trained personnel for the audits of the Republic Companies."

Plaintiffs further allege that the breach of said duties by Peat, Marwick, Mitchell & Co. "caused each of the named plaintiffs for themselves and as representative parties of a class, to be damaged by unknowingly depositing funds and property in the hands of the bankrupt Republic Companies during the period the . . . auditors reports were in effect, to their detriment and loss, which loss would not have occurred had said depositors, certificate and note holders, . . . known the true financial and insolvent condition of said companies."

With respect to the Defendant Sunbelt Bank & Trust Company (Sunbelt), formerly Republic Bank & Trust Co., a State Bank Association, Plaintiffs allege that it "and its officers and directors, knowingly and willfully operated said bank in conjunction with the holding companies, the first and second Republic Bancorporation, Inc., [RTS] and [RFC] in a concerted and willful designing manner that deceived Plaintiffs to purchase securities of bankrupt [Republic Companies]"; that "[s]ome of the acts of the Defendant directors of [Sunbelt] and [Sunbelt] itself was the use of [its] officers and staff at [its] offices . . . to counsel Plaintiffs on the purchase of securities from the [bankrupt Republic Companies]; [the] transfer of per-

sonnel between various Republic Companies and encouragement of customers/plaintiffs to follow personnel and to do business with various entities; false and misleading advertisement of Republic Companies as one cohesive group with total assets of in excess of $190,000,000.00 . . . and use of exact same logos among all Companies and deceptively similar names"; that "[Sunbelt] and its directors during 1983 through at least August, 1984, manipulated the loan portfolio of each of the Republic Companies, bankrupt and non-bankrupt, by moving good loans to [Sunbelt], and moving non-performing loans to the now bankrupt Republic Companies"; that "[a]ll of said acts were accomplished through the use of the United States mail, long distance telecommunications, and solicitation of Oklahoma, Texas and Arizona residents, as well as residents of other states"; that "[a]ll of said acts were relied on by Plaintiffs in purchasing securities from [bankrupt Republic Companies]" and caused Plaintiffs damages.

Plaintiffs further allege that "[o]n or about June 29, 1984, [Sunbelt] and its directors attempted to secretly divest itself from the other Republic Companies, except the first Republic Bancorporation, Inc."; that "[a]s early as December, 1983, [Sunbelt] filed applications for divestiture determination . . . which was denied by the Federal Reserve Board in June, 1984"; that "[b]ecause of the secret and covert action by [Sunbelt] and its directors to separate from Republic Companies Plaintiffs had no indication or notice of the breakup or attempted breakup of the '190 million dollar' family of Republic Companies"; that "[Sunbelt] and its directors and officers knew of the impending financial collapse of Republic Companies at the time of the attempted divestiture," and that "[t]hese omissions of such divestiture disclosure was a material fact to Plaintiffs in their decision to continue to purchase and hold securities of Republic Companies that filed bankruptcy less than three months after the attempted divestiture."

Plaintiffs further allege that "[e]ach of the defendants, working separately and in concert with each other, did conspire to defraud the Plaintiffs . . . using the tool of controlling ownership and controlling management of the Republic Companies"; that McKinney, "individually, and through the vehicle of the

McKinney Family Trusts which McKinney had absolute control over, dominated and controlled RBI of Oklahoma, Inc., which in turn owned [RBI] which in turn owned [RFC], [RTS] . . . and controlling interests in [Sunbelt]"; that "McKinney, as a result of dominance and control . . . also controlled the appointment and serving of all members of the Board of Directors, all officer and employees of the Republic Companies, and the selection, direction and activities of the auditing firm of Peat, Marwick & Mitchell Co."; that "McKinney had interlocking members of the Board of Directors, some of which were Defendants, Anderson, Degen, Wilder, Ozwalt, Akin, Ramsey and Prichard, all of which were on the Board of Directors of the first [RBI], [Sunbelt], [RFC], and [RTS]"; that "[t]o effectuate the conspiracy to defraud, the Republic Companies issued securities as evidence of the transactions"; that "[a]fter receipt of funds, the Republic Companies would assemble the funds into common pools, and would lend the funds, both with and without security"; that "[t]he Defendants would indiscriminately move assets and liabilities between the various Republic Companies"; that "at the time of the . . . fraudulent activities, the Defendants moved, transferred and shifted assets knowing, or should have known, that no repayment would be made, or that there was little likelihood of repayment"; that "a direct and active participant in the conspiracy to defraud was the accounting and auditing firm of Peat, Marwick, Mitchell & Co., in that annually, and on numerous other occasions [it] did prepare and disseminate a consolidated auditing report, reporting all the Republic Companies as a unit, with accompanying separate audit reports for each company of the Republic family";[2] that "[a]ll of the Defendants acting individually and in concert with one another, did directly and indirectly make false, fraudulent and material misrepresentations to the Plaintiffs, as a class of the financial condition of the bankrupt companies through the preparation, auditing and dissemination of statements pertaining to the financial condition of the bankrupt Republic Companies, knowing at the time that said statements were false and/or made recklessly without any knowledge of

2 The alleged acts and actions of Peat, Marwick, Mitchell & Co. are described above.

their truthfulness and as a positive assertion"; that "each of the Defendants made such material misrepresentations with the intention that the Plaintiffs as depositors, certificate and note holders of the bankrupt Republic Companies, would act upon said representation, and [Plaintiffs] did in fact act and rely upon said audited financial statements and representations by said Plaintiffs delivering funds to said bankrupt Republic Companies and receiving therefrom certain evidence of indebtedness which now have little to no value." Plaintiffs seek compensatory damages in the sum of $72,200,000.00 plus interest and punitive damages of $722,000,000.00.

MOTION OF DEFENDANT PEAT, MARWICK, MITCHELL & CO. TO DISMISS PURSUANT TO FED.R.CIV.P. 12(b)(1)

In support of its Motion to Dismiss, Peat, Marwick, Mitchell & Co. contend the Court lacks subject matter jurisdiction, in that Plaintiffs Amended Complaint fails to allege jurisdictional facts identifying a security based on the Securities Acts of 1933 and 1934, as amended; that in the alternative, Plaintiffs fail to state a claim upon which the Court can grant relief against Peat, Marwick, Mitchell & Co.; that Plaintiffs' fail to allege all of the elements required in either a security fraud or common law fraud action; that the elements which Plaintiffs do mention are not alleged with the specificity required by Fed.R.Civ.P. 9(b); that in particular, Plaintiffs fail to allege facts showing any misstatements or omissions of material facts, scienter, reliance and damages; that Plaintiffs fail to allege the elements required in a claim under 15 U.S.C. § 77k, and that Plaintiffs also fail to allege an actionable private claim against Peat, Marwick, Mitchell & Co. for violation of 15 U.S.C. § 77q.

Peat, Marwick, Mitchell & Co. further assert that none of the banking instruments issued by the bankrupt Republic Companies are securities under the Securities Exchange Act of 1934 or the Securities Act of 1933; that none of the subject instruments meet the test announced by the Supreme Court in *SEC v. Howey Co.*, 328 U.S. 293, 301 (1946) which "test is whether the scheme involves an investment of money and a common enter-

prise with profits to come solely from the efforts of others." (Brief of Peat, Marwick, Mitchell & Co. filed January 28, 1985 at 10).

With respect to the instruments issued by RTS, Peat, Marwick, Mitchell & Co. assert that "RTS is a depository institution regulated by the Oklahoma Department of Banking"; that "[i]t operates as a stock company"; that "[i]n exchange for the currency deposits it received, it gave the traditional banking-type instruments of passbook savings accounts and fixed-rate, fixed-term certificates of deposit"; that "[i]t used the currency deposits to make loans"; that "[t]he contractual obligation to return the currency deposited, along with the contracted amount of interest, was independent of the profitability of the loans RTS made," and that "Plaintiffs do not allege facts to the contrary." (*Id.* at 11-12).

Peat, Marwick, Mitchell & Co. further contend that "[t]hree courts which have examined passbook savings accounts have held that they are not securities within the definition of the 1934 Act."[3] (citing *Hamblett v. Board of Savings & Loan Associations of the State of Mississippi*, 472 F. Supp. 158 (N.D. Miss. 1979), *Hendrickson v. Buchbinder*, 465 F. Supp. 1250 (S.D. Fla. 1979)), and *Burrus, Cootes & Burrus v. MacKethan* 537 F.2d 1262 (4th Cir. 1976)). Peat, Marwick, Mitchell & Co. notes that "[t]he reasoning of [*Burrus*] remains persuasive, although it was later withdrawn as moot"; that "[a]fter the withdrawal of the opinion numerous courts cited the original opinion with approval." (*Id.* at 16). (citing *Canadian Imperial Bank v. Fingland*, 615 F.2d 465, 468 n. 10 (7th Cir. 1980); *Hendrickson*, *supra* and *Hamblett*, *supra*).

With respect to the RTS certificates of deposit, Peat, Marwick, Mitchell & Co. contend that "[a]s in the case of the passbook savings account, the certificates of deposit, labeled Six Month Money Market Thrift Certificates and Negotiable

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3 The Supreme Court has "consistently held that the definition of 'security' in the 1934 Act is essentially the same as the definition of 'security' in § 2(1) of the Securities Act of 1933, 15 U.S.C. § 77b(1)." *Marine Bank v. Weaver*, 455 U.S. 551, 556, n. 3 (1982) (citing *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 847, n. 12 (1975)).

Rate Term Thrift Certificates, given by RTS are not securities under the 1933 and 1934 Acts"; that "plaintiffs do not explain the terms, conditions or circumstances of the RTS certificates of deposit"; that "[t]he only exhibits attached to the complaint establish the traditional banking-type nature of the RTS certificates of deposit and show that those certificates of deposit are not securities"; that "[n]umerous courts, including the Supreme Court, have held that the allegation of a certificate of deposit, without more, does not constitute a security and therefore does not give a federal court jurisdiction in a securities action." (citing *Marine Bank v. Weaver, supra*; *Canadian Imperial Bank of Commerce v. Fingland, supra*; *Bellah v. First National Bank of Hereford*, 495 F.2d 1109 (5th Cir. 1974); *Brockton Savings Bank v. Peat, Marwick, Mitchell & Co.*, 577 F. Supp. 1281 (D. Mass. 1983)). (*Id.* at 17-21).

With respect to RFC, Peat, Marwick, Mitchell & Co. urge that for the same reasons asserted in connection with RTS, the passbook savings accounts and certificates of deposit issued by RFC "are not securities as defined by federal law." (*Id.* at 22-23).

As to RBI, Peat, Marwick, Mitchell & Co. state that "[t]he only facts stated by the Plaintiffs indicated that several weeks after Peat, Marwick resigned as auditors, plaintiff, Cal Acree received a 91-day note for $84,319.73 with interest at the rate of 11.875% per annum"; that "Peat, Marwick was no longer auditor at the time of the issuance of the note in question"; that "Peat, Marwick had also informed the Republic Companies that they should tell all persons whom the companies believed might be relying on the auditor reports and the financial statements that reliance on those documents was no longer appropriate"; that "15 U.S.C. Section 78(c)(10) excludes the 91-day note from the definition of a security," which "section provides in part: 'The term security . . . shall not include currency or any note, draft, bill of exchange or banker's acceptance which has a maturity at the time of issuance of not exceeding 9 months, exclusive of days of grace, or any renewal thereof, the maturity of which is likewise limited.' " (*Id.* at 23-24).

Additionally, Peat, Marwick, Mitchell & Co. asserts that "the 91-day note is not a security for purposes of the 1933

Act''; that ''[t]he reasoning which excludes passbooks and certificates of deposit from the definition of a security likewise excludes this 91-day note from that definition.'' (*Id.* at 24).

In response, Plaintiffs contend that under the 1933 Act and the 1934 Act ''the term 'security' means any note, . . .''; that under the 1933 Act ''the term 'security' means any . . . evidence of indebtedness,'' and that instruments issued by the bankrupt Republic Companies (Exhibits 1 through 28) ''may be categorized as 'evidence of indebtedness' . . . [and] may also be categorized as 'notes' '' under the Federal Securities Acts of 1933 and 1934. (Plaintiffs' responsive brief filed February 28, 1985 at 2-3).

Plaintiffs further assert that ''Defendants err in insisting that the securities Plaintiffs purchased must meet the elements of 'investment contract', as defined by the *Howey* test''; that in *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 847, n. 12 (1975), the Court held that Congress . . . sought to define the term 'security' in sufficiently broad and general terms so as to include within that definition the many types of instruments that in our commercial world fall within the ordinary concept of a 'security'.'' (*Id.* at 3-4). Plaintiffs further note that in *Weaver* the ''court indicates that a certificate of deposit is within the definition of the Securities Acts unless the context otherwise requires''; that ''[t]he Court makes an exception in *Weaver* for a certificate of deposit issued by a *bank* [emphasis in original]''; that ''[a]lthough RTS and RFC allied themselves as closely as possible with [Sunbelt], . . . they [and RBI] were not banks''; that ''RBI, RTS and RFC were not subject to the comprehensive federal regulation the *Weaver* court found so important in reaching its conclusions.'' (*Id.* at 5). Plaintiffs quote the following language from *Weaver*:

> In our view, . . . there is an important difference between a bank certificate of deposit and other long-term debt obligations. This certificate of deposit was issued by a federally regulated bank which is subject to the comprehensive set of regulations governing the banking industry. [footnote omitted] Deposits in federally regulated banks are protected by the reserve, reporting, and inspection require-

> ments of the federal banking laws; advertising relating to the interest paid on deposits is also regulated. In addition, deposits are insured by the Federal Deposit Insurance Corporation. Since its formation in 1933, nearly all depositors in failing banks insured by the FDIC have received payment in full, even payment for the portions of their deposits above the amount insured.

455 U.S. 557, 558. (*Id.* at 5). Plaintiffs further note that "[f]ederal regulation also played a significant role in . . . *International Brotherhood of Teamsters, etc. v. Daniel*, 439 U.S. 551 . . . (1979) . . . [where] [t]he court decided that [a non-contributory, compulsory] pension plan was not a security," holding that "[t]he existence of this comprehensive legislation [ERISA] governing the use and terms of employee pension plans severely undercuts all arguments for extending the Securities Acts to non-contributory, compulsory pension plans." 439 U.S. 569. The Court in *Daniel* further noted:

> Congress believed that it was filling a regulatory void when it enacted ERISA, a belief which the SEC actively encouraged. Not only is the extension of the Securities Acts by the court below unsupported by the language and history of those Acts, but in light of ERISA, it serves no general purpose. Whatever benefits employees might derive from the effect of the Securities Acts are now provided in more definite form through ERISA.

439 U.S. 569, 570. (*Id.* 5-6).

Plaintiffs urge that "[u]nderlying both the *Weaver* and *Daniel* decisions is the fact that the plaintiffs in those cases were protected by comprehensive and effective federal legislation other than the Securities laws"; that "Plaintiffs in this case have no effective regulatory protection other than the Securities laws, nor do they have the protection provided by insurance"; that "[r]egulation of RBI, RTS and RFC was so fragmented amongst the various state regulatory agencies that effective regulation of the whole as envisioned by the U. S. Supreme Court was impossible"; and that "[t]he bankruptcy filings of RBI, RTS, and RFC reinforce this point." (*Id.* at 6-7).

Plaintiffs further contend that the *Howey* test is inapplicable with respect to the instruments issued by the bankrupt Republic Companies; that "[i]n *Weaver*, the court mentions the *Howey* test but fails to use the elements thereof in reaching this decision"; that the post-*Weaver* cases, *Wolf v. Banco Nacional de Mexico*, 739 F.2d 1458 (9th Cir. 1984) and *Hunssinger v. Rockford Business Credits, Inc.*, 745 F.2d 484 (7th Cir. 1984) also hold that the *Howey* test is not applicable as to certain debt instruments, and should not be applied with respect to the debt instruments issued by the bankrupt Republic Companies. (*Id.* at 7-12)

Plaintiffs further rely on *Banowitz v. State Exchange Bank*, 600 F. Supp. 1466 (N.D.Ill.E.D. 1985) where "officers and employees of the [State] Bank sold to the individual plaintiffs investment notes issued by SEFCO . . . an Indiana corporation incorporated . . . by certain owners of the Bank." *Id.* at 1468. "[T]he Bank shared common officers and directors . . . [and] SEFCO's business was conducted by employees of the Bank." *Ibid.* The Plaintiffs alleged that:

> . . . the bank caused SEFCO to take numerous loans to various officers and directors and related persons or businesses, without adequate documentation or collateral and at lower than market interest rates; the Bank caused SEFCO to pay various personal expenses of . . . Bank/SEFCO officers and directors; the Bank authorized the transfer of unduly risky or defaulted loans from the Bank to SEFCO; . . . officer and director defendants either authorized, permitted, or recklessly disregarded the above actions.
>
> . . .
>
> . . . the Amended Complaint . . . alleges that defendants violated Section 10(b) of the 1934 Act and Rule 10b-5 promulgated thereunder. Defendants contend that . . . the SEFCO investment notes are not "securities" within the meaning of the 1934 Act. This argument is based upon the exception, contained only in the 1934 Act, to the definition of a "security": "The term 'security' . . . shall not include . . . any note . . . which has a maturity at the

time of issuance of not exceeding nine months. . . ." [footnote omitted]. Because plaintiffs' notes matured in less than nine months, [footnote omitted] defendants claim that there can be no cause of action under Rule 10b-5.

The real issue here is whether the notes in this case are "commercial promissory notes" or "investment securities." In *Sanders v. John Nuveen & Co.*, 463 F.2d 1075 (7th Cir.), *cert. denied*, 409 U.S. 1009, 93 S.Ct. 443, 34 L.Ed.2d 302 (1972), the Seventh Circuit held that short term notes with maturities of less than nine months were "securities" protected by Section 10(b) of the 1934 Act and Rule 10b-5. The Seventh Circuit explained the meaning of the statutory exception as follows:

> ". . . when Congress spoke of notes with a maturity not exceeding nine months, it meant commercial paper, not investment securities. When a prospective borrower approaches a bank for a loan and gives his note in consideration for it, the bank has purchased commercial paper. But a person who seeks to invest his money and receives a note in return for it has not purchased commercial paper in the usual sense. He has purchased a security investment.

Id. at 1080. The court further implied that where the purchasers of notes are individual members of the public, an inference is raised that the notes are investment securities. *Id.* at 1080 n. 18. . . . "The ultimate question is whether the plaintiffs are simply borrowers in a commercial transaction who are not protected by the 1934 Act or investors in a securities transaction who are protected."

. . .

. . . Both the analysis and the holding of the Supreme Court in *Marine Bank* refute the implication that a note with a maturity of less than nine months can in no circumstances be a "security" within the 1934 Act. Thus, *Marine Bank v. Weaver* supports the Seventh Circuit's focus on

the context of the transaction rather than on the literal meaning of the statutory words. [footnote omitted]

In this case, plaintiffs' allegations clearly demonstrate that plaintiffs did not borrow money from SEFCO in return for a commercial promissory note, but rather that they gave their money to the finance company in return for investment securities. [footnote omitted] This court therefore holds that the SEFCO investment notes purchased by plaintiffs are "securities" within the meaning of the 1934 Act and the protection of Rule 10b-5.

In discussing the different tests used by the courts to determine whether a particular debt instrument is a "security" under the 1933 and 1934 Federal Acts, the court in *Wolf v. Banco Nacional de Mexico*, *supra*, stated:

The parties cite to us numerous "tests" used by this Court and others to define a "security" in other cases, *e.g.*, the "economic realities" test, *Securities & Exchange Commission v. W. J. Howey Co.*, 1946, 328 U.S. 293, 66 S. Ct. 1100, 90 L.Ed. 1244, and *United Housing Foundation, Inc. v. Forman*, 1975, 421 U.S. 837, 95 S. Ct. 2051, 44 L.Ed.2d 621, the "risk capital" test, *Great Western Bank & Trust v. Katz*, 9 Cir., 1976, 532 F.2d 1252, *see Landreth Timber Co. v. Landreth*, 9 Cir., 1984, 731 F.2d 1348, 1352; and the "commercial/investment" test, *Bellah v. First National Bank of Hereford*, 5 Cir., 1974, 495 F.2d 1109.

However, when the Supreme Court, in *Marine Bank v. Weaver* has so recently applied the definition to facts very similar to those in the case before us, we are bound by its reasoning there, to the exclusion of criteria articulated in other contexts.

. . . .

Plaintiffs in *Weaver* held a $50,000, six-year certificate of deposit issued by a federally regulated Pennsylvania bank. The certificate paid 7-1/2% interest although the bank could charge an interest penalty upon early withdrawal of the principal. The holders had pledged the cer-

tificate as security for a bank loan to a packing company. After the packing company failed and the bank prepared to claim the certificate of deposit, the holders sued, alleging, *inter alia*, that the bank had violated the anti-fraud provisions of the 1934 Act, 15 U.S.C. § 78j(b).

On appeal from the Third Circuit, the Court held that the certificate of deposit was not a security.

. . . .

The Court observed that while the holder of an ordinary long-term debt "assumes the risk of the borrower's insolvency," government banking regulations "virtually guaranteed" that the holder of a Marine Bank certificate of deposit would be repaid in full. *Ibid.* It concluded,

> The definition of "security" in the 1934 Act provides that an instrument which seems to fall within the broad sweep of the Act is not to be considered a security if the context otherwise requires. It is unnecessary to subject issuers of bank certificates of deposit to liability under the antifraud provisions of the federal securities laws since the holders of bank certificates of deposit are abundantly protected under the federal banking laws. We therefore hold that the certificate of deposit purchased by the Weavers is not a security.

Id. at 558-559, 102 S. Ct. at 1225. The Court added, however, "It does not follow that a certificate of deposit . . . invariably falls outside the definition of a 'security' as defined by the federal statutes. Each transaction must be analyzed and evaluated on the basis of the content of the instruments in question, the purposes intended to be served, and the factual setting as a whole." *Id.* at 560, n. 11, 102 S. Ct. at 1225 n. 11.

In its analysis of *Weaver*, the district court thought it crucial that Marine Bank was regulated by the United States government and held that because *federal* banking laws do not regulate Banamex, *Weaver* did not control. We do not read *Weaver* so narrowly. The Court referred there to "federally regulated bank" and "federal banking laws" because the case arose in that context. We think that

the Court found it significant that the issuing bank was regulated and regulated adequately, not that it was the federal government that regulated it. Therefore, it was because repayment in full was "virtually guaranteed" and the certificate holders were "abundantly protected" that the certificates of deposit were outside the definition of "security" and the protection of the federal securities acts.

. . . .

Our decision, therefore, is compelled by the reasoning of *Weaver* that when a bank is sufficiently well regulated that there is virtually no risk that insolvency will prevent it from repaying the holder of one of its certificates of deposit in full, the certificate is not a security for purposes of the federal securities laws.

There remains the matter of how such regulation is to be proved. The Supreme Court in *Weaver* was able to take judicial notice of the breadth and adequacy of the federal regulations protecting the holder of a certificate of deposit issued by Marine Bank. In a situation such as the case before us, where a foreign government's regulatory structure is implicated, the trial court must hear evidence on the degree of protection that structure offers a depositor against insolvency. Because the foreign bank in this situation has better access to such evidence than the certificate holder, the bank shall bear the burden of proving such regulation, as an affirmative defense to a securities law charge. If the adequacy of the regulatory structure is proved, a certificate of deposit issued in a customary banking transaction is not, under *Weaver*, a security.

739 F.2d at 1460-1463.

In *Wolf* the court noted that "[t]he Supreme Court in *Weaver* was able to take judicial notice of the breadth and adequacy of the federal regulations protecting the holder of a certificate of deposit issued by Marine Bank," and that "[i]n the case before [it], it was conceded that the Mexican government's regulation of Banamex provides its certificate holders the same degree of protection against insolvency as does the federal system in this country." 739 F.2d at 1463. The Court further sug-

gested that when there is a factual issue with respect to the particular "government's regulatory structure" in regard to the protection offered the certificate holders, "the trial court must hear evidence on the degree of protection that structure offers a depositor against insolvency." *Ibid.*

In their responsive brief Plaintiffs state that "Plaintiffs in this case have no effective regulatory protection other than the securities laws, nor do they have the protection provided by insurance," and that "[r]egulation of [RBI], RTS, and RFC was so fragmented amongst the various state regulatory agencies that effective regulation of the whole as envisioned by the U. S. Supreme Court was impossible." (Plaintiffs' responsive brief filed February 28, 1985 at 6-7). On the other hand, Defendants assert that "RFC, RBI and RTS were all regulated and examined by governmental entities . . . and fixed rates were paid"; that "RBI, RTS and RFC were regulated and examined by the Federal Reserve"; that RTS and RFC were additionally regulated and examined by the agencies of the State of Oklahoma"; and "[i]n RTS' case, the agency was the Oklahoma Department of Banking." (Reply brief of Peat, Marwick, Mitchell & Co. filed April 11, 1985 at 7).

It is the view of this Court that because of the need to consider evidence on the "regulatory structure" issue with respect to the RBI, RTS and RFC debt instruments, the motions to dismiss of those defendants who do not, in the alternative, seek summary judgment, should be converted to motions for summary judgment and disposed of as provided in Rule 56.

Therefore, the parties are granted until November 1, 1985 to complete discovery on the "regulatory structure" issue. Plaintiffs will file a supplementary brief by November 15, 1985 and the Defendants will file responses to Plaintiffs' supplemental brief by November 29, 1985.

MOTIONS OF DEFENDANTS TO DISMISS PURSUANT TO FED.R.CIV.P. RULE 12(b)(6) FOR FAILURE TO STATE A CLAIM FOR EITHER SECURITIES FRAUD OR COMMON LAW FRAUD

In support of its Motion to Dismiss Pursuant to Fed. R.Civ.P. 12(b)(6), Defendant Peat, Marwick, Mitchell & Co., contends that "Plaintiffs' attempt to state a claim for both federal securities fraud and common law fraud fails for two reasons"; that "[i]nitially, plaintiffs do not allege, even in conclusory form, all the elements necessary to properly plead fraud"; and "[a]dditionally, the few elements which plaintiffs do allege are not stated with the particularly required by Fed. R.Civ.P. 9(b)." (Brief of Defendant Peat, Marwick, Mitchell & Co. filed January 28, 1985 at 25).

Peat, Marwick, Mitchell & Co. further contend that "plaintiffs have failed to allege several of the elements of fraud . . . fail to allege a misstatement or omission of any material fact . . . do not . . . identify the auditing standards not followed, the manner in which those standards were not followed or the resulting impact, if any, on the financial statements and auditor reports . . . do not identify any fact represented by Peat, Marwick as material . . . do not identify any fact which they claim Peat, Marwick misrepresented . . . do not allege that the purported errors or omissions of Peat, Marwick had any material effect on the auditor opinions which Peat, Marwick issued . . . do not identify what Peat, Marwick would have discovered if Peat, Marwick had conducted the audit in the manner plaintiffs desired, nor do plaintiffs state what effect, if any, those alleged audit failures of Peat, Marwick had on the financial statements or the auditor reports . . . fail to identify how Peat, Marwick used unqualified personnel and what effect, if any that use had on the auditor reports . . . although claiming the financial statements were inaccurate, fail to allege the facts showing what parts contained inaccuracies, the specific contents alleged to be inaccurate and the materiality of inaccuracies . . . fail to adequately allege scienter . . . fail to state facts indicating reliance . . . fail to allege actual damages caused by Peat, Marwick . . . [and] [i]n addition to their failure to allege

federal securities fraud, the plaintiffs have not alleged with requisite specificity Oklahoma common law fraud." (Brief of Peat, Marwick, Mitchell & Co. filed January 28, 1985 at 28-34).

Sunbelt Bank & Trust Company, Sunbelt Bancorporation, Inc., RBI of Oklahoma, Inc., and the individual defendants also complain about the lack of specificity. Sunbelt contends that "Plaintiffs' blanket assertions, unsupported by any specifics of alleged fraudulent activity . . . fails to meet the threshold requirements of Rule 9(b)"; that "[t]here is absolutely no indication as to which individual defendant is accused of which acts of alleged fraud and conspiracy," and that although "Plaintiffs allege various misrepresentations, [t]hey do not allege what statements were made, how they were made, where they were made, to whom they were made, when they were made, who made them, or what was misleading about them." (Sunbelt's Brief filed January 28, 1985 at 14). Sunbelt also contends that Plaintiffs complaint is insufficient as to its "Section 12 claims" in that "Plaintiffs' Amended Complaint Does Not Allege that Sunbelt Bank was a 'Seller' of Securities . . . Contains No Offer to Tender Securities . . . Fails to Set Forth Facts Demonstrating Compliance with the Applicable Statutes of Limitation," and that "There is No Section 17 Private Right of Action." (*Id.* at [ii]).

Because the contentions of Peat, Marwick, Mitchell & Co. and Sunbelt are typical of those made by the other Defendants in their various motions to dismiss, the Court will not set forth the contentions of each of the remaining Defendants.

The Defendants, Taylor, Born, Sullivan, and Allred have filed affidavits in support of their respective motions to dismiss or in the alternative for summary judgment. No counter affidavits have been filed by Plaintiffs in response to those Defendants' affidavits.

Also, a number of the Defendants seek in the alternative to their motions to dismiss, an order of the Court requiring the Plaintiffs to file a more definite statement pursuant to Rule 12(e).

Section 10(b) of the 1934 Act makes it unlawful "[t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in

contravention of such rules and regulations as the commission may prescribe . . . ." 15 U.S.C. § 78j(b).

Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated pursuant to Section 10(b) provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility or any national securities exchange
>
> (1) to employ any device, scheme or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading,
>
> (3) to engage in any act, practice or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

The misrepresentations or omissions must be material. *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54, 92 S. Ct. 1456, 31 L.Ed. 2d 741 (1972). Materiality is an element of common law fraud that is required by the express language of Rule 10b-5(2). In *Mitchell v. Texas Gulf Sulphur Co.*, 446 F.2d 90 (10th Cir. 1971), *cert. denied*, 404 U.S. 918, 92 S. Ct. 546, 30 L.Ed. 2d 558 (1971), *rehearing denied*, 405 U.S. 918, 92 S. Ct. 943, 30 L.Ed. 2d 778 (1972), the Court held that "[m]isrepresented or omitted facts become material, hence actionable under 10b-5 when, considering the complaining parties as reasonable investors, the disclosure of the undisclosed facts or candid revelation of misleading facts would affect their trading judgment. . ." In the *Affiliated Ute* case, *supra*, at 153-54, the Supreme Court said: "Under the circumstances of this case, involving primarily a failure to disclose, positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable

investor might have considered them important in the making of his decision."

A defendant must have acted with some form of scienter beyond mere negligence. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1374, 47 L.Ed. 2d, 668 (1976), the Court defined scienter as "[a] mental state embracing intent to deceive, manipulate or defraud." 425 U.S.-194, Footnote 12. In *Aaron v. SEC*, 446 U.S. 680, 100 S. Ct. 1945, 64 L.Ed. 2d 611 (1980), the Supreme Court expressly did not "address the question, reserved in Hochfelder, . . . whether, under some circumstances, scienter may also include reckless behavior." *Id.* at 686 n. 5. See also *Huddleston v. Herman & MacLean*, 640 F.2d 534 (5th Cir. 1981). In certain areas of the law recklessness is considered to be a form of intentional conduct for purposes of imposing liability for some act. *Hochfelder, supra*, at 193-94 n.12.

In *Hackbart v. Holmes*, 675 F.2d 1114, 117-18 (10th Cir. 1982), the Court stated:

> At this time we expressly hold that recklessness satisfies the scienter requirement. We do so for the same reasons given by the other circuits: first, because the Securities Acts are to be broadly construed to achieve their remedial goals, *Mansbach*, 598 F.2d at 1024 (citing Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972)); second, because requiring the Plaintiff to show intent would be unduly burdensome, *Thompson*, 636 F.2d at 961 n.32; *Mansbach*, 598 F.2d at 1025; *Rolf*, 570 F.2d at 47; and third, because the Securities Acts were intended to proscribe actions akin to common law fraud, *see Hochfelder*, 425 U.S. at 212 n.32 (reviewing legislative history and finding that the SEC believed the rule would proscribe fraudulent behavior), and reckless behavior satisfies the scienter requirement of common law fraud, *Mansbach*, 598 F.2d at 1024. For purposes or applying Rule 10b-5, the best definition of reckless behavior is conduct that is "an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the Defendant or is so obvious that

> the actor must have been aware of it." *Sundstrand Corp.*, 553 F.2d at 1045 (quoting Franke v. Midwestern Okla. Dev. Auth., 428 F. Supp. 719, 725 (W.D. Okla. 1976).

In *Franke v. Midwestern Okl. Dev. Authority*, 428 F. Supp. 719, 725 (W.D. Okl. 1976), *vacated on other grounds*, *Cronin v. Midwestern Okl. Dev. Authority*, 619 F.2d 856 (1980), the trial court stated:

> In the context of an omissions case, reckless conduct may be defined as a highly unreasonable omission, involving not merely simple, or even unexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the Defendant or is so obvious that the actor must have been aware of it.

Accord, e.g., McLean v. Alexander, 599 F.2d 1190, 1197 (3rd Cir. 1979); *Mansbach v. Prescott, Ball & Turben*, 598 F.2d 1017, 1025 (6th Cir. 1979); *Sundstrand Corp. v. Sun Chem. Corp.*, *supra*, 553 F.2d 1033; *Securities & Exchange Com'n v. Southwest Coal*, 624 F.2d 1312, 1321 n.17 (5th Cir. 1980).

There must be a causal connection between the claimed violations of Section 10(b) and Rule 10b-5 and the injuries allegedly suffered by the plaintiffs. *Affiliated Ute*, *supra*, 406 U.S. at 154.

In *Titan Groups, Inc. v. Gaggen*, 513 F.2d 234, 238 (2nd Cir. 1975), *cert. denied*, 423 U.S. 840, the Court said "[t]he parallel elements of materiality and reliance both serve to restrict the potentially limitless thrust of Rule 10b-5 to those situations in which there exists a causation in fact between the act and the injury.

With respect to "a duty to disclose", the Court in *Woods* stated:

> Plaintiffs contend that the bank is primarily liable because it had a duty to disclose material misrepresentations and omissions directly to the bondholders. If true, silence or inaction could lead to a finding of Rule 10b-5 liability. *Kerbs v. Fall River Indus., Inc.*, 502 F.2d 731, 739-40 (10th Cir. 1974). The trustee bank maintains that it

> had no duty of disclosure to the bond purchasers. *Resource Investors v. Natural Resources Inv. Corp.*, 457 F. Supp. 194, 200 (E.D.Mich.1978). However, the Tenth Circuit recently reversed a trial court's entry of summary judgment for a trustee bank on this issue. *Cronin, supra.* The court indicated that *participation in the issuance of the bonds could result in a duty of disclosure to all buyers.* (emphasis added)

489 F. Supp at 1278.

The court further stated:

> . . ."[t]he Bank may be subject to primary liability for Rule 10b-5 violations if it owed a direct duty to the public. *Cronin v. Midwestern Oklahoma Development Authority* [619 F.2d 856 (10th Cir. 1980)] The bank could also be found secondarily liable under an aiding and abetting theory if it has sufficient knowledge of and participation in the rule 10b-5 scheme. *Ibid*

As to the aider-abettor situation, the Tenth Circuit Court of Appeals, with many other circuits, has recognized liability of alleged aiders and abettors under § 10(b) and Rule 10b-5, See *Kerbs v. Fall River Industries, Inc.*, 502 F.2d 731, 740 (10th Cir. 1974) [pre-*Hochfelder*] and *Cronin v. Midwestern Okl. Dev. Authority*, 619 F.2d 856, 862 (10th Cir. 1980) [post-*Hochfelder*]. However, the Supreme Court of the United States, in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 96 S. Ct. 1374, 47 L.Ed. 2d 668, n.7 (1976), *rehearing den.*, 425 U.S. 185, 96 S. Ct. 2194 (1976), declined to determine whether civil liability for aiding and abetting is appropriate under § 10b and Rule 10b-5.

To support an aiding and abetting claim it must be alleged that (i) an independent wrong existed; (ii) the aider and abettor rendered substantial assistance to the primary wrongdoer; and (iii) the aider and abettor had the requisite scienter. *Woods v. Homes & Structures of Pittsburg, Kansas*, 489 F. Supp. 1270, 1278 (D. Kans. 1980); *Troyer v. Karcagi*, 476 F. Supp. 1142, 1151 (S.D.N.Y. 1979)

In *Woods*, the Kansas trial court stated in dealing with an aiding and abetting theory against F&M based on the issuance of industrial development bonds:

> . . . The elements of aiding and abetting in a Rule 10b-5 violation are: (1) proof of securities law violations; (2) proof that the alleged aider-abettor knew of the violations and of its role in the scheme; and (3) proof that the alleged aider-abettor knowingly and substantially assisted in the violation. [case citations omitted]. In relation to the knowledge requirements of aiding-abetting, we note the Fifth Circuit's statement in Woodward, supra, at 95: "The scienter requirement scales upward when activity is more remote; therefore the assistance rendered should be both substantial and knowing. A remote party must not only be aware of his role, but he should also know when and to what degree he is furthering the fraud;" The Fifth Circuit states further at 97:
>
> > "When it is impossible to find any duty of disclosure, an alleged aider-abettor should be found liable only if scienter of the high 'conscious intent' variety can be proved. Where some special duty of disclosure exists, then liability should be possible with a lesser degree of scienter."
>
> Plaintiffs and F&M agree that establishing recklessness might be sufficient to satisfy the scienter requirement for aiding and abetting liability if the bank had a fiduciary duty to the bondholders. [case citations omitted]. Without proof that F&M had a duty of disclosure, the standard of scienter Plaintiffs will be required to meet will be one of conscious intent. Without a duty to disclose, imposition of secondary liability using a standard of recklessness or a "should have known" test would effectively mean liability for negligence. This would contravene the rule of Ernst & Ernst v. Hochfelder . . . .

In considering a 12(b)(6) Motion to Dismiss, the Court must accept as true the material facts alleged in the Complaint. *Reynolds v. United States*, 643 F.2d 707, 708 (10th Cir. 1981).

As stated by the Court in *Bryan v. Stillwater Board of Realtors*, 578 F.2d 1319, 1321 (10th Cir. 1977),

> A rule 12(b)(6) motion to dismiss for failure to state a claim upon which relief may be granted puts in issue the legal sufficiency of plaintiff's declaration by admitting all of the well pleaded facts in the plaintiff's pleadings, thereby taking the position that even if all of those allegations are true, still no relief is warranted. Wright and Miller, Federal Practice and Procedure, Rule 12, §§ 1355, 1356, 1357, pp. 587-617. The test most often applied to determine the sufficiency of the complaint to state a claim is set forth in Conley v. Gibson, 355 U.S. 41 (1957):
>
> > . . . In appraising the sufficiency of the complaint we follow, of course, the accepted rule that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.
> >
> > 355 U.S., at pp. 45, 46.
>
> *Accord*: Jenkins v. McKeithen, 395 U.S. 411 (1969); Bell v. Hood, 327 U.S. 678 (1946); Dewell v. Lawson, 489 F.2d 877 (10th Cir. 1974); Gas-A-Car, Inc. v. American Petrofina, Inc., 484 F.2d 1102 (10th Cir. 1973); Franklin v. Meredith, 386 F.2d 598 (10th Cir. 1967); Fed.Rule Civ. Proc., rule 8(a), 28 U.S.C.A.

Plaintiffs contend that they have satisfied the requirements of Rules 8(a) and 9(b). (citing, *inter alia*, *In Re Commonwealth Oil/Tesoro Petroleum Corp. Secur. Litigation*, 467 F. Supp. 227 (W.D. Tex. 1979); *Re Home-Stake Production Co. Secur. Litigation*, 76 F.R.D. 337 (N.D. Ok. 1975); *Banowitz v. The State Exchange Bank*, *supra*). In *Banowitz* the Court stated that:

> The Seventh Circuit has interpreted Rule 9(b) liberally, stating that it must be read in conjunction with the notice pleading standard of Rule 8. *Tomera v. Galt*, 511 F.2d 504 (7th Cir.1975). The Court in *Tomera* held that Rule 9(b)

> was satisfied by a "brief sketch of how the fraudulent scheme operated, when and where it occurred, and the participants." *Id.* at 509.
>
> . . .
>
> Defendants also contend . . . that where, as here, multiple defendants are involved, the complaint must provide reasonable notice of the part each defendant allegedly played in the scheme. *Lincoln National Bank v. Lampe*, 414 F. Supp. 1270, 1278 (N.D. Ill.1976); *Adair*, 526 F. Supp. at 744. That rule is modified, however, where the multiple defendants are all corporate insiders. Numerous courts have held that the conduct of such individuals need not be specified and the fraudulent acts complained of need not be attributed to certain persons if the complaint sufficiently describes the fraudulent acts and provides the individuals with sufficient information to answer the allegations. *See, e.g., Pellman v. Cinerama, Inc.*, 503 F. Supp. 107, 111 (S.D.N.Y. 1980) (and cases cited therein).

Id. at 1469.

In substance, the thrust of Plaintiffs' Amended Complaint is that the bankrupt Republic Companies, RFC, RTS and RBI were engaged in the offering and sale of securities to the public during the years 1982, 1983 and 1984; that Peat, Marwick, Mitchell & Co. was employed during those years by McKinney and his Republic Companies and knew that the Republic Companies were engaged in the offering and sale of the debt instruments which Plaintiffs contend are securities under the 1933 and 1934 Acts; that during those years all of the defendants participated in a scheme to defraud plaintiffs through the sale of securities offered by the bankrupt Republic Companies, which offerings contained false and fraudulent information as to the ownership, assets, liabilities and net worth of the bankrupt and non-bankrupt Republic Companies; that the officers and directors of the various bankrupt and non-bankrupt Republic Companies aided and abetted and conspired with certain Defendants by committing certain acts as outlined above including, *inter alia*, the manipulation of loan portfolios of the bankrupt and

non-bankrupt companies, the moving of good loans to Republic Bank, the moving of non-performing loans to the now bankrupt Republic Companies, and the moving of assets and liabilities between the various Republic Companies for the purpose of deceiving potential lenders of funds to the Republic Companies.

Defendants' contentions that Plaintiffs' Amended Complaint fails to meet the pleading requirements of Rules 8(a) and 9(b) of the Federal Rules of Civil Procedure, and that such pleading deficiencies require that the complaint be dismissed pursuant to Rule 12(b)(6) are without merit and Defendants' motions to dismiss on those grounds are denied. *See Bryan v. Stillwater Board of Realtors, supra*, where the court states "that a complaint should not be dismissed for failure to state a claim unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." 578 F.2d 1319, 1321 (quoting *Conley v. Gibson, supra*, 355 U.S. at pp. 45, 46).

Since the Court has converted all of the Defendants' Motions to Dismiss into Motions for Summary Judgment and has granted the parties until November 1, 1985 to conduct discovery on the "regulatory structure" issue, the Defendants should have sufficient time to submit interrogatories to Plaintiffs to obtain the specific information that they contend they need in order to answer the Amended Complaint as urged in their Rule 12(b)(6) Motions to Dismiss.

The Plaintiffs should also file affidavits and/or other evidence in response to the affidavits which have been filed by some individual Defendants in support of their motions for summary judgment.

DEFENDANTS' MOTIONS TO DISMISS THE AMENDED COMPLAINT AS TO PLAINTIFFS' CLAIM UNDER SECTION 17(A) OF THE SECURITIES ACT OF 1933, 15 U.S.C. § 77(a)

In the Order filed by this Court in *Westland Energy 1981-1 Ltd. v. Bank of Commerce and Trust Company*, No. 83-C-1025-B (N.D. Ok. December 10, 1984), this Court found "the

majority view of the circuit courts which have considered the § 17(a) private right of action issue to be persuasive, particularly in light of the Supreme Court's decision in [*Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983)], and held that a private right of action is permitted under § 17(a) of the 1933 Act.

MOTIONS OF DEFENDANTS PEAT, MARWICK MITCHELL & CO. AND SUNBELT BANK & TRUST CO. TO STRIKE OR DISMISS PLAINTIFFS' CLASS ACTION ALLEGATIONS

The issues raised by Defendants' Motions to Strike or Dismiss Plaintiffs' Class Action Allegations and Plaintiffs' response thereto will be held in abeyance pending the Court's ruling on the Motions for Summary Judgment.

IT IS THEREFORE ORDERED that the parties proceed with discovery as outlined herein. Discovery should be limited at this time, however, to those issues raised by Defendants' Motions for Summary Judgment. Upon the completion of discovery and the filing of additional briefs, the Court will then rule upon all motions for summary judgment.

IT IS SO ORDERED this 20th day of September, 1985.

/s/ LUTHER B. EUBANKS
United States District Judge

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Republic Financial Corporation
PASSBOOK SAVINGS CERTIFICATE

THIS IS TO CERTIFY that:

_____

_____

Full Name and Address

is the registered owner of this Republic Financial Corporation (hereinafter referred to as Company) Passbook Savings Certificate and that the Company is indebted to the registered owner hereof in the amount shown by the last balance for this account together with interest thereon at the rate of _____% per annum compounded quarterly subject to the Uniform Rules Regulating this Certificate.

IN WITNESS WHEREOF, we have caused this certificate to be executed by a duly authorized officer of the Company this ____ day of _____, 19___.

REPUBLIC FINANCIAL CORPORATION

_____
Secretary

_____
President

UNIFORM RULES REGULATING THIS CERTIFICATE

(1) This certificate is issued as evidence that the person(s) whose name(s) appears hereon is the registered owner of this certificate and that the Company is indebted to the registered owner for the amount as shown by the last balance for this account together with interest thereon at the current stated rate of interest as is in effect at the time which is compounded quarterly.

(2) Interest will be credited to this account on March 31, June 30, September 30 and December 31 and will be credited to principal and earn interest from the date of credit.

(3) Withdrawals from and deposits to this account may be made at any time in person, by mail or by electronic funds transfer, where available.

(4) This certificate may be issued as payable to one or the other of two or more persons, in which event payment to the properly authorized person(s), or his duly appointed representative, shall discharge the Company from all liability to all owners hereunder.

(5) This certificate may be issued to a minor person in his own name and without regard to parent or guardian, and payments made hereunder shall discharge the Company from all liability hereunder to such owner, or his parent or guardian.

(6) The Company will furnish to the registered owner as of March 31, June 30, September 30 and December 31 a statement of this account which will reflect all deposits, withdrawals and interest credited during reporting date. This statement of account will be mailed to the registered owner to the last address of the registered owner as furnished to the Company. Any discrepancy in the statement of account should be promptly communicated to the Company within thirty (30) days of receipt of the statement of account by the registered owner. Failure to do so may relieve the Company from all liabilities in connection therewith.

(7) The Company reserves the right to modify the rules regulating this certificate and to change the stated rate of interest which will be paid hereon; provided that, however, it shall give the registered owner hereof notice of its intentions to modify such rules or to change the stated rate of interset in writing thirty (30) days in advance by mail addressed to the last address of the registered owner as furnished to the Company.

(8) The Company does not maintain a sinking fund for the retirement of this certificate. The amount due pursuant to this certificate is payable on demand; provided, however, that the Company may require thirty (30) days' written notice of intent to redeem amounts due hereunder and may limit redemptions in any one calendar month for all certificates issued by the Company to fifty percent (50%) of the net cash flow of the Company for the preceding calendar month, in which event certificates will be redeemed in such order in which they are presented for payment.

(9) The provisions herein constitute the full agreement between the registered owner and the Company without reference to any other instrument.

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PLAINTIFF'S EXHIBIT 00002

NAME Maxine Black or Linda Woodard N°. 945425
ADDRESS 506 High Street, Henryetta, Oklahoma 74437

SIX MONTH MONEY MARKET THRIFT CERTIFICATE

THIS IS TO CERTIFY that for value received this certificate has this date been issued to Maxine Black or Linda Woodard for and in consideration of the sum of $Five thousand dollars and no/100 ($5,000.00) Dollars cash in hand paid, the receipt of which is hereby acknowledged. This certificate shall bear interest at 12% per annum, compounded, or payable quarterly, and shall be due and payable six months from date and shall be payable only upon surrender of this certificate. The Company reserves the right to redeem this certificate at any time after issue upon thirty (30) days written notice to the holder hereof of its intention to redeem. The holder of this certificate may redeem this certificate at any time after issue provided, however, that the Company may require thirty (30) days written notice to the Company of such intention to redeem and that the Company reserves the right to limit all redemptions of certificates in any calendar month to fifty percent (50%) of the net cash flow of the Company for the preceding calendar month; and further provided that a substantial early withdrawal interest penalty will apply. In

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the event of early withdrawal, this certificate will receive interest equal to the rate currently in effect for Passbook Savings Certificates less an amount equal to three months interest at such rate.

IN WITNESS WHEREOF, we have caused this certificate to be executed by a duly authorized officer of the Company this 10th day of May, 1984.

REPUBLIC TRUST & SAVINGS

[ILLEGIBLE]
Asst. Secretary

THE CERTIFICATE ISSUED HEREBY IS NOT INSURED BY ANY AGENCY OF A FEDERAL OR STATE GOVERNMENT.

[ILLEGIBLE]
Vice President